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Exam

Rev. Proc. 94-69's Post-Filing Disclosures to Survive in Some Form

By George A. Hani and Colin J. Handzo*

I. Introduction

For decades, large corporate taxpayers have relied on procedures outlined in Rev. Proc. 94-69 in order to make post-filing disclosures and receive penalty protections.[1] In general, accuracy-related penalties are waived in the case of disclosures or adjustments reflected on a qualified amended return ("QAR") filed before the taxpayer is first contacted about an audit.[2] But, for large corporate taxpayers under continuous or near-continuous audit, filing a QAR is rarely an option. Rev. Proc. 94-69 allows taxpayers under continuous audit to show additional tax due or make disclosures in order to avoid certain accuracy-related penalties after the commencement of an audit.[3]

The procedures have been enormously popular among taxpayers and Internal Revenue Service ("IRS") employees because they promote the objectives of sound tax administration. The U.S. federal tax system is one of voluntary compliance, and the related penalty regime is in place to promote such compliance—this does not always or necessarily mean compliance only on the original return. The procedures under Rev. Proc. 94-69 fulfill a necessary role in the disclosure and examination process because they: allow (and incentivize) affirmative disclosures, simplify audits, promote transparency, promote collaboration between Exam and taxpayers, and provide expeditious problem-solving solutions. Taxpayers also enjoy the additional benefit of avoiding the cost and complexity of filing sometimes multiple amended state tax returns.

After some recent uncertainty, it appears such post-filing disclosures will continue to provide such mutually beneficial efficiencies. In 2020, the availability of these disclosures seemed in doubt. At that point, the IRS announced it was considering revoking Rev. Proc. 94-69 given the IRS's Large Business & International division's ("LB&I's") plan to wind down their formal continuous audit program.[4] After receiving enthusiastic comments from stakeholders advocating that the IRS not obsolete Rev. Proc. 94-69's procedures (as well as internal comments), the IRS recently announced that it will be replacing—not obsoleting—Rev. Proc. 94-69.[5]

In its 2022 Announcement, the IRS released a new draft Form 15307, "*Post-filing Disclosure for Specific Large Business Taxpayers*," which aims to standardize disclosures under a new process. In addition, the IRS solicited comments on that draft form. The 2022 Announcement also noted that further IRS guidance will be forthcoming as to which taxpayers will be eligible to make such disclosures, and it is this question that is on many taxpayers' minds. In our view, in order to achieve the intended goals of Rev. Proc. 94-69, this pool of eligible taxpayers should be sufficiently broad to allow as many taxpayers as possible to avail themselves of the post-filing disclosure procedures without providing an avenue for taxpayers to abuse the procedures. That is, the guidance should exclude people who would likely use the procedures to play the audit lottery and still gain penalty protection.

II. Background

Under Rev. Proc. 94-69, taxpayers subject to the former Coordinated Examination Program ("CEP") may, after the commencement of an audit, show additional tax due or make disclosures in order to avoid accuracy-related penalties under Code Secs. 6662(b)(1) (disregard or rules or regulations) and (b)(2) (substantial understatement of income tax).[6] Within 15 days of receiving the IRS's first written information request, the taxpayer may provide a written statement that will be treated as a QAR.[7] Although such disclosures and adjustments generally must be made before an audit is commenced for penalty protection purposes, the IRS has previously supported this exception to the rule stating that the time of first contact was not appropriate for CEP taxpayers because, generally, all CEP returns are examined.[8] Rev. Proc. 94-69 continued to apply to taxpayers subject to continuous audits when the CEP was replaced by the Coordinated Industry Case ("CIC") program in the early 2000s.

In 2019, the IRS replaced the CIC with the Large Corporate Compliance ("LCC") program beginning with audits of the 2017 tax year. Unlike prior programs, the LCC is not premised on the assumption that all LCC taxpayers will be under continuous examination. Instead, LCC taxpayers are identified based on objective criteria and a point system in which points are assigned based on such items as gross assets and the number of operating entities.[9] From this pool, LCC returns are then annually evaluated for examination using advanced data analytics to identify the LCC returns with the highest risk.[10]

In May 2019, the IRS announced transition rules that allowed Rev. Proc. 94-69 to apply to taxpayers then subject to audit under both the CIC (for pre-2017 tax years) and the LCC programs.[11] The IRS followed this up in August 2020 with a request for comments on the potential revocation of Rev. Proc. 94-69.[12] LB&I stated various concerns as the reasons for the proposed revocation, including the following:

- Rev. Proc. 94-69 creates a disparity among taxpayers because taxpayers outside the scope of Rev. Proc. 94-69 may generally only use the QAR process,
- LCC taxpayers may file QARs before they are contacted by Exam about an audit,
- The revenue procedure does not improve the accuracy or reliability of returns when they are filed,
- All taxpayers may submit informal claims for refunds within 30 calendar days of the opening conference.[13]

Following the 2020 request, the IRS received a deluge of comments supporting 94-69's procedures[14] for myriad reasons, including the following:

- Filings QARs each time an error is identified is not practical—the taxpayer's time spent and cost will be unduly burdensome, especially because of the complexity of filing sometimes multiple state amended returns. Reviewing multiple QARs filed by LCC taxpayers would also be time- and resource-intensive for the IRS;
- Rev. Proc. 94-69, reasonably, allows all mistakes to be fixed at one time (at the end of an audit following proper disclosure);
- Taxpayers under continuous audit may never be able to receive penalty protection without Rev. Proc. 94-69 or similar rules;[15]
- Obsoleting Rev. Proc. 94-69 would not improve the accuracy of original returns because the types of errors disclosed under the procedures are generally not known (and are not knowable) at the time the original return is filed;
  - For instance, Rev. Proc. 94-69 is often used to disclose items attributable to events that happen after the original return is filed, such as completion of prior-year examinations that result in carryover adjustments or the issuance of Schedules K-1 by partnerships;
  - In addition, no amount of diligence can ensure there are no errors in the first cut of the biggest multinational taxpayers' tax returns or their reported book income (which, in turn, impacts their federal tax returns);
- Rev. Proc. 94-69 promotes trust and collaboration between taxpayers and the IRS. The procedure encourages taxpayers to make disclosures to the IRS who would otherwise need to discover these errors themselves—this can be a difficult task with the

complex computations that make up LCC taxpayer returns.[16]

III. Current State of Affairs

The IRS appears to be receptive to the comments it received. In its 2022 Announcement, the IRS acknowledged that there is a "small subset of taxpayers who will likely be in some form of continuous audit posture with LB&I because of the nature of their transactions and return filings" and acknowledged that some form of disclosure process for this group "may be appropriate."[17] The 2022 Announcement solicited comments on a new draft Form 15307, which is aptly titled "*Post-filing Disclosure for Specific Large Business Taxpayers*." The Form aims to standardize the process for making these disclosures by ensuring that eligible taxpayers and revenue agents are working with consistent guidelines as to what amounts to a disclosure that will afford penalty protection. The form and instructions require specific information to be considered an "adequate disclosure," including the following:

- Number of Disclosures;
- Adjustment Type;
- Timing (Permanent or Temporary Adjustment);
- Effect on Carryover;
- IRS Form(s), Page(s), and Line Number(s) Impacted by the Disclosure;
- Description; and
- Increase (Decrease) to Taxable Income/Tax Credits.[18]

The instructions also provide several examples of acceptable and unacceptable disclosure descriptions. They note that unacceptable disclosures will not result in penalty protection and will cause the filer to be ineligible to use Form 15307 for a yet-to-be-determined time period. Finally, the instructions note that netting of adjustments is generally not permitted. Harkening back to the advent of Schedule UTP for Uncertain Tax Positions, many taxpayers were criticized for cryptic descriptions on the Schedule UTP. However, Schedule UTP was mandatory rather than voluntary. In the context of voluntary disclosure, taxpayers are actively seeking a benefit (*i.e.*, penalty protection) and thus should be incentivized to provide a more fulsome description to ensure penalty protection. This is not unlike the analysis some currently undertake with respect to disclosures on a Form 8275, which is a disclosure statement specific to penalty protection and included with an original or amended return. The question is "how much to tell is enough"?

Importantly, Form 15307 must be signed under penalties of perjury—something no corporate officer would take lightly.[19] Thus, the Form is in line with the spirit of Rev. Proc. 94-69. It provides an avenue for taxpayers that are frequently under audit to comply with the Code, but still comes with heavy responsibilities which should ensure that any taxpayer that files the Form includes, to the best of their knowledge and belief, true, correct, and complete information.

IV. Next Steps

The trickiest part of replacing Rev. Proc. 94-69 is also the question that remains on everyone's mind—which taxpayers will be eligible to file disclosures? The IRS has deferred answering the question, though they intimated in their 2022 Announcement that eligibility will be tied to a "continuous audit population" that will be defined in upcoming guidance and will not be specifically tied to the LCC.[20] The announcement also noted that Treasury's 2021–2022 Priority Guidance Plan included an entry for this update to Rev. Proc. 94-69, titled: "Revenue procedure regarding special rules for qualified amended returns filed by certain large corporations."[21]

All taxpayers should be on the lookout for the finalization of Form 15307 (whether adopted in its current form or with changes) and for guidance defining the pool of taxpayers eligible to use the Form.

Several organizations have suggested ways to best define the population that should be able to take advantage of Rev. Proc. 94-69's successor, though many of these recommendations came before the 2022 Announcement. One popular recommendation has been for the IRS and Treasury to continue to apply disclosure procedures similar to Rev. Proc. 94-69 to any LCC taxpayer that has been under examination for three of the prior five tax years at the time it is notified of a new exam.[22] This recommendation seeks to equate to *de facto* continuous examination taking into account audit cycles skipped due to net operating loss years or other factors that may temporarily reduce a taxpayer's audit risk profile, and given the IRS's 2022 Announcement, this recommendation appears to be the most likely to be adopted by the IRS in some form. This recommendation has several merits. For instance, it successfully identifies a group for which procedures akin to Rev. Proc. 94-69 are absolutely necessary—the existence of multiple, ongoing audits is likely to prevent this group from being eligible to file QARs, making them unable to make adequate disclosures under Code Sec. 6662 to avoid penalties. This group is also not likely to include taxpayers who play the audit lottery. Since these taxpayers are unlikely to know (or be able to adequately predict) which years will be skipped for audit, they are likely to file every return with some reasonable expectation of being audited.

Taxpayers should also consider the practical steps they could take now with regard to returns that have already been filed and for which the IRS may open audits in the near future.

Because the IRS has noted that their definition of "continuous audit population" will not be associated with any one program, we are hopeful that the IRS will allow any taxpayer that meets the three-out-of-five-year (or similar) requirement to utilize Form 15307, regardless of whether they are LCC taxpayers. There is no policy reason to limit the universe of eligible taxpayers to LCC taxpayers. And this tweak makes sense, as any taxpayer under audit three out of five years is just as likely to be ineligible to file a QAR and just as likely to prepare its return with a reasonable expectation of being audited. Further, expanding the scope beyond LCC taxpayers eliminates the perception that LCC taxpayers are favored or receive preferential treatment as compared to other taxpayers. It makes sense for this approach to apply to any taxpayer that meets the three-out-of-five test.

The tax community has made several other meritorious recommendations. Another suggestion has been to apply disclosure procedures similar to Rev. Proc. 94-69 to LCC taxpayers that are notified of the opening of a new examination while currently under exam for an earlier year or within 120 days of when the exam for an earlier year ends.[23] The proposed 120-day window is similar to the existing audit protection rule in Rev. Proc. 2015-13 for accounting method changes.[24] This suggestion has merit, especially because it would allow taxpayers to flexibly make disclosures near the end of an earlier exam when a carryover adjustment may come to fruition. These taxpayers are unlikely to be eligible to file a QAR and the recommendation also appears to mostly capture taxpayers that will expect that most of their tax years will be examined. Similar to the comments above, there is no reason for this category of eligible taxpayers be limited to LCC taxpayers. If this test is adopted, it seems appropriate to allow all taxpayers that meet the test to have the same opportunity for penalty protection.

Another suggestion has been to apply disclosure procedures akin to those of Rev. Proc. 94-69 to LCC taxpayers that are already subject to enhanced reporting requirements—for instance, those required under Reg. §1.6038-4(a) to file Form 8975, "*Country-by-Country Report*."[25] U.S. multinationals required to file this Form with regard to their worldwide operations are likely to have transfer pricing issues and potentially be subject to a Code Sec. 6662(e) penalty for which a reasonable cause defense may not be available.[26] Taxpayers in this category have an independent reason to report their tax positions accurately on the original return; thus, there would be no detrimental effect of allowing them to utilize disclosure procedures.

One final suggestion has been to apply an updated version of Rev. Proc. 94-69 to any LCC taxpayer before first being contacted by the IRS with respect to an exam for the tax year to which the disclosure relates (or, for a taxpayer notified of the exam of a tax year before the original return was filed, prior to the exam commencing).[27] Any disclosure would identify an issue and associated amount. The IRS could then consider whether to include the disclosed items in the revenue agent's report ("RAR") if they open an exam, or, if no exam is opened, the taxpayer would file a QAR incorporating the disclosed items to receive penalty protection. The LCC taxpayer could withdraw the disclosure (if, for instance, the disclosure was made in error), and any disclosure, QAR, or withdrawal would need to be made within 180 days of the assessment statute closing to allow the IRS time to review the issue. Finally, if the taxpayer fails to comply with the delineated procedures, the IRS could put in place rules to deny penalty protection or to make taxpayers ineligible to file additional disclosures for a period of time. Although somewhat complicated, if implemented correctly, such procedures could achieve many of the goals of Rev. Proc. 94-69. It would disallow taxpayers from making disclosures with the benefit of hindsight while still incentivizing taxpayers to make post-filing disclosures, even if such disclosures increase the tax they ultimately owe.

One issue with this final proposal is what to do if the taxpayer is not selected for audit. With the first three proposals discussed above, any adjustments that might be appropriate based on the disclosure can be made in the course of the audit. If the taxpayer is not selected for audit, the only mechanism to make any adjustments would be for the taxpayer to file an amended return. Some commentators have suggested that the taxpayer be obligated to file an amended return in the event it is not selected for audit. We would not go that far. To the extent this proposal is adopted, we believe that the disclosure would put the IRS on notice of the potential need for adjustments, and if the IRS does not exercise its discretion to open an audit, then no adjustment needs to be made. Taxpayers would need to be cognizant of the duty of consistency and not double dip on any items on subsequent returns. But, since there is generally no obligation to file an amended return, we see no reason to impose the obligation when the IRS has chosen not to open an audit.

Regardless of how the IRS ultimately decides to define the pool of taxpayers eligible to file future Form 15307, the IRS should announce a final transition rule that treats all LCC taxpayers the same. For instance, it would be beneficial if the IRS continues to allow use of Rev. Proc. 94-69 through examinations of a specific future tax year. In the alternative, the IRS should continue to apply the current grandfather rule to exams already in progress for tax years ending before the date Rev. Proc. 94-69 is officially obsoleted, modified, or replaced.

V. Conclusion

The comment period for the draft Form 15307 closed on June 3. The tight comment window as well as the inclusion of the item on the Priority Guidance Plan suggests that the IRS hopes to have the Rev. Proc. 94-69 replacement in place soon and hopefully in 2022. All taxpayers should be on the lookout for the finalization of Form 15307 (whether adopted in its current form or with changes) and for guidance defining the pool of taxpayers eligible to use the Form. Taxpayers should also consider the practical steps they could take now with regard to returns that have already been filed and for which the IRS may open audits in the near future.

ENDNOTES

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1 Rev. Proc. 94-69, 1994-2 CB 804.

2 Reg. §1.6664-2(c)(2)-(3). *See also* Code Sec. 6662(d)(2)(B); Reg. §§1.6662-3(a), (c); 1.6662-4(a), (e)-(f). All "Section" and "§" references are to the Internal Revenue Code of 1986, as amended (the "Code"), or the Treasury regulations promulgated thereunder.

3 Rev. Proc. 94-69, 1994-2 CB at 804-05.

4 Dep't of Treasury, IRS, *IRS seeks comments on Rev. Proc. 94-69* (Aug. 19, 2020), *www.irs.gov/newsroom/irs-seeks-comments-on-revenue-procedure-94-69* ("2020 Announcement").

5 Dep't of Treasury, IRS, *Inviting Input Through June 3, 2022 on Draft Form for Disclosures by Certain Large Business Taxpayers* (Feb. 25, 2022), *www.irs.gov/businesses/corporations/inviting-input-through-june-3-2022-on-draft-form-for-disclosures-by-certain-large-business-taxpayers* ("2022 Announcement").

6 Rev. Proc. 94-69, 1994-2 CB at 804-05.

7 *Id.* at 805-06.

8 *See, e.g.*, Rev. Proc. 85-26, 1985-1 CB 580, 580.

9 *See* IRM 4.50.5 (May 24, 2021); Douglas O'Donnell, *Memorandum for All Large Business and International Division Employees: Interim Guidance on Implementation of the Large Corporate (LCC) Program*, LB&I-04-0419-004 (May 21, 2019), ("O'Donnell Memorandum").

10 *See id.*

11 *See* 2020 Announcement. (citing O'Donnell Memorandum). *See also* IRM 4.50.3.3.3.2 (May 24, 2021) ("Regarding Rev. Proc. 94-69 .... Continue to apply to any taxpayer that had an open CIC exam as of May 21, 2019 and the taxpayer's 2017 return was LCC.").

12 2020 Announcement.

13 *Id.*

14 Commenters included notable organizations such as the American Bar Association Section of Taxation and Tax Executives Institute, Inc.

15 *See* Reg. §1.6664-2(c)(2), (3)(i)(A).

16 Letter to Hon. C. Rettig, Commissioner, IRS, from J. Arnold, Chair, American Bar Association, Tax Section, regarding Comments on Rev. Proc. 94-69 (Oct. 20, 2020) ("ABA Comment Letter"); Letter to IRS, from J. Kennedy, Tax Executives Institute, Inc., regarding Proposed Elimination of Rev. Proc. 94-69 (Oct. 16, 2020) ("TEI Comment Letter").

17 2022 Announcement.

18 IRS Form 15307, "*Post-Filing Disclosure for Specified Large Business Taxpayers*"; Instructions for Form 15307.

19 *Id.*

20 2022 Announcement.

21 2021-2022 Priority Guidance Plan at 18, *www.irs.gov/pub/irs-utl/2021-2022-pgp-initial.pdf* (setting forth the published guidance that Treasury, IRS, and Counsel plan to work on during the 2022 fiscal year).

22 ABA Comment Letter; TEI Comment Letter.

23 ABA Comment Letter.

24 Rev. Proc. 2015-13, §8.02(1)(b), 2015-5 IRB 419.

25 ABA Comment Letter.

26 This recommendation has been tied to disclosures and penalty protection as specifically permitted under Reg. §1.6662-6(a)(2).

27 ABA Comment Letter.

