

## **Part III -- Administrative, Procedural, and Miscellaneous**

### **Pre-Filing Agreements Pilot Program**

#### **Notice 2000-12**

##### **1. INTRODUCTION OF PILOT PROGRAM**

This Notice announces a pilot program for Pre-Filing Agreements (PFAs), under which large business taxpayers may request examination and resolution of specific issues relating to tax returns they expect to file between September and December, 2000. The purpose of the program is to enable both taxpayers and the Internal Revenue Service (IRS) to resolve before filing the treatment of issues otherwise likely to be disputed in post-filing audits. Through a cooperative effort, the program is intended to reduce the costs, burden and delays encountered in post-filing examinations.

The program is administered by the Large and Mid-size Business Division (LMSB) of the IRS. In its pilot phase, the program is open to large businesses that currently have a Coordinated Examination Team on site. Taxpayers interested in participating in the pilot program, or with questions about the program and its suitability to their situation, should contact their on site Case Manager as soon as possible, and are encouraged to apply on or before March 15, 2000, to ensure their application will be given full consideration. LMSB is willing to meet with taxpayers considering participation in the program to answer questions and explore the desirability of their participation.

During the pilot phase of the program, LMSB plans to select approximately five to ten taxpayers from among those requesting participation in the program. LMSB will select participants as soon as possible after March 15, 2000, and provide taxpayers and audit teams an orientation about the program. The team will work with the selected taxpayer with the expectation of resolving the designated issue by the taxpayer's filing deadline. Taxpayers participating in the pilot program will be asked to assist in monitoring and evaluating the process. After completing the pilot cases, the IRS will evaluate the program, and may then offer the program, after further modification, on a permanent basis.

The IRS believes that the PFA program offers significant potential benefits for taxpayers as well as the IRS, and invites large business taxpayers to participate in this program.

## 2. DESCRIPTION OF A PRE-FILING AGREEMENT

A PFA is a closing agreement under § 7121 of the Internal Revenue Code between the IRS and taxpayer relating to one or more specific issues arising from transactions entered into by the taxpayer during a taxable period ending prior to the date of the agreement. The agreement specifies the treatment of the transaction(s) on a tax return to be filed by the taxpayer subsequent to the date of the agreement. A PFA may also resolve related specific items affecting other taxable periods. See Rev. Proc. 68-16, 1968-1 C.B. 770, which describes the preparation of closing agreements under § 7121.

The PFA's application of the law to the taxpayer's facts may result in treating an item differently from earlier treatments of similar items in prior taxable years (e.g., deducting items that previously were capitalized, such as certain ISO 9000 costs). If so, the differing treatment may constitute a change in the method of accounting for that item. The PFA will resolve only the factual characterization of the items at issue, but will not constitute the Commissioner's consent to make any accounting method change that may be required to conform the agreed upon treatment of the item with identical items in earlier years. Permission to make any accounting method changes required by the PFA's resolution of the factual and legal issues must be obtained using the applicable administrative procedures. See Rev. Proc. 99-49, 1999-52 I.R.B. 725 (automatic consent to change certain accounting methods); Rev. Proc. 97-27, 1997-1 C.B. 680.

## 3. SUBJECT MATTER OF AN LMSB PRE-FILING AGREEMENT

**In general.** The PFA program is intended to advance the resolution of issues that are otherwise likely to be disputed in post-filing audits. The program is intended to reach agreement on factual issues and apply settled legal principles to those facts. In such cases, the presence of an LMSB audit team on site shortly after the completion of the transaction is most likely to enhance the prospects for an agreed resolution of the issue. Questions concerning the correct interpretation of legal rules the interpretation of which is not well settled are more properly presented in requests for private letter rulings. See Rev. Proc. 2000-1, 2000-1 I.R.B. 4. Moreover, the program is not available to settle disagreements between a taxpayer and the IRS over the correct interpretation of the tax laws (except as authorized under Delegation Order No. 236 or 247 regarding settlement guidelines).

The IRS will consider entering into a PFA on any issue involving the application of settled legal principles requested by the taxpayer, except as noted below. Issuance of a PFA is discretionary with the LMSB Industry Director. A PFA cannot resolve issues for taxpayers or years outside the jurisdiction of LMSB. In evaluating whether to proceed with the PFA process and to enter into a PFA, the IRS will determine that the issue presented is consistent with the overall goals of the program stated above.

**Examples.** The following are examples of issues likely to be suitable for resolution through the PFA program:

- (1) The valuation of assets (except in the context of transfer pricing), and the allocation of the purchase or sale price of a business among the assets acquired or sold;
- (2) The identification and documentation of hedging transactions;
- (3) Issues relating to in-house research expenses under section 41;
- (4) The allocation of costs among different categories of deductible and capitalizable items in contexts in which there is a published revenue ruling, e.g., repairs (Rev. Rul. 94-12, 1994-1 C.B. 36), advertising (Rev. Rul. 92-80, 1992-2 C.B. 57), and Y2K costs (Rev. Proc. 97-50, 1997-2 C.B. 525);
- (5) The determination of which costs are investigatory costs incurred to determine whether to enter a new business and which business to enter for purposes of qualifying as start-up costs under § 195 (see Rev. Rul. 99-23, 1999-20 I.R.B. 3);
- (6) The determination of 'market' for taxpayers using the lower of cost or market method of inventory valuation in situations involving inactive markets. See § 1.471-4(b);
- (7) Whether a taxpayer's financial statement preparation of its last-in, first-out (LIFO) inventory is consistent with the LIFO conformity requirement under § 1.472-2(e);
- (8) Whether a taxpayer's inventory contains 'sub-normal' goods within the meaning of § 1.471-2(c) and the valuation placed thereon;
- (9) Whether a taxpayer is considered the tax owner of the property being produced under § 1.263A-2(a)(1)(ii)(A);
- (10) Whether a manufacturing contract newly entered into by a taxpayer is required to be accounted for as a long-term contract under § 460; and
- (11) The determination of appropriate asset classes for depreciable property placed in service during the taxable period.

**Excluded subjects.** A PFA will not be entered into with respect to the following issues:

- (1) Issues that can be included in an Advance Pricing Agreement under Rev. Proc. 96-53, 1996-2 C.B. 375, (e.g., transfer pricing);
- (2) Issues that can be resolved by requesting a change in accounting method on Form 3115;
- (3) Issues under the jurisdiction of the Commissioner, Tax Exempt and Government Entities Division (e.g., employee plans);
- (4) Issues regarding transactions that lack a bona fide business purpose or have as their principal purpose the reduction of federal taxes;
- (5) The satisfaction, for purposes of Subtitle F (Procedure and Administration), of reasonable cause, due diligence, good faith, clear and convincing evidence, or any similar standard; and
- (6) The applicability of any penalty or criminal sanction.

**Excluded circumstances.** In addition, the IRS will not entertain a request for a PFA in the following circumstances:

- (1) The issue (for the taxpayer) involves a partnership item as defined in § 6231, or is subject to the procedures set forth in § 6221 through § 6233.
- (2) The issue is or will be the subject of a pending or contemporaneous request for a private letter ruling or a change in accounting method by the taxpayer;
- (3) The taxpayer's proposed resolution of the issue is contrary to a private letter ruling, technical advice memorandum, or closing agreement previously issued to or regarding the taxpayer;
- (4) The taxpayer's proposed resolution of the issue is contrary to a position adverse to the taxpayer proposed by the IRS in response to a private letter ruling (or accounting method change) request that was withdrawn by the taxpayer; or
- (5) The issue is the subject of litigation (or has been designated for litigation by the Office of Chief Counsel) between the IRS and the taxpayer with respect to an earlier taxable period.

For the purposes of these excluded circumstances, any reference to the taxpayer also includes a related taxpayer and any predecessor of the taxpayer or a related taxpayer. A related taxpayer is one related within the meaning of § 267 or a member of an affiliated group within the meaning of § 1504 that includes the taxpayer. A predecessor

is an entity the tax liability of which the taxpayer or a related taxpayer is or was primarily or secondarily liable.

#### **4. PROCEDURES FOR REQUESTING AN LMSB PRE-FILING AGREEMENT**

**Before initiating a formal request.** Taxpayers interested in participating in the pilot program, or with questions about the program and its suitability to their situation, should contact the LMSB Case Manager supervising the audit of the return currently under examination as soon as possible. Taxpayers also may contact John Petrella, the PFA Program Manager, at (202) 283-8390 (not a toll-free number), for further information about the PFA program.

**Initiating the request.** After discussing the proposed request with their Case Manager, the taxpayer must submit a request for a PFA in writing through the Case Manager to the LMSB Industry Director. Taxpayers are encouraged to submit the request on or before March 15, 2000, to ensure their application will be given full consideration. The PFA Program Manager and the Case Manager are available to assist in the preparation of the submission.

**Contents of the request.** The written statement requesting a PFA should concisely:

- (1) Provide the taxpayer's name, EIN, and address and the name, title, address and telephone number of a person to contact;
- (2) Provide the Case Manager's name and telephone number;
- (3) Identify the taxable period for which the PFA is sought, the last date on which the taxpayer may file (with extensions) a timely return for that period, and (if earlier) the date on which the taxpayer intends to file that return;
- (4) Describe the issue(s) for which the PFA is sought. Summarize the material facts and state the legal issue(s) involved. For the purpose of ascertaining that the issue involves the application of settled law, discuss the taxpayer's interpretation of these legal rules and their proposed application to the facts in question;
- (5) Discuss the suitability of the issue for the PFA program in light of the purposes and criteria set forth in section 3, above;
- (6) Represent that the issue is not described in any of the "Excluded Circumstances" listed in section 3, above;
- (7) Discuss whether the resolution of this issue will have any effect in taxable periods either before or after the taxable period for which the PFA is sought;

- (8) State whether the taxpayer has ever applied, or intends to apply, for Competent Authority assistance with respect to the issue for the year in question or any prior year;
- (9) Discuss whether the issue identified can be resolved through a PFA by the date on which the taxpayer intends to file its return for the taxable period in question;
- (10) Describe the organization and location of the records and other evidence that substantiate the taxpayer's proposed position on the issue;
- (11) State that the taxpayer agrees that the inspection of records and testimony under the PFA procedures will not preclude or impede (under § 7605(b) or any administrative provisions adopted by the IRS) a later examination of a return or inspection of records with respect to any tax year needed to resolve the issue(s) in the request for a PFA, and that the IRS need not comply with any applicable procedural restrictions (such as providing notice under § 7605(b)) before beginning such examination or inspection; and
- (12) Indicate the taxpayer's willingness to participate in a pilot program and to assist in monitoring and evaluating the process.

**Perjury statement.** A request for a PFA, and any supplemental submission (including additional documents), must include a declaration, signed by a person currently authorized to sign the taxpayer's federal income tax return, in the following form:

Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and, to the best of my knowledge and belief, the facts presented in support of the request for the Pre-Filing Agreement are true, correct and complete.

**Signature.** The request for a PFA must be signed by the taxpayer or the taxpayer's authorized representative. If the request is signed by an authorized representative, a copy of Form 2848, Power of Attorney and Declaration of Representative, must accompany the request.

**No user fee.** During the pilot phase of this program, no user fee is required to request a PFA.

## **5. PROCEDURES FOR SELECTING TAXPAYERS FOR THE PILOT PROGRAM**

**Case Manager's Role.** Case Managers will inform the PFA Program Manager of all instances in which taxpayers express interest in participation in the program, and will

forward a copy of any written request to the LMSB Industry Director and the PFA Program Manager. The Case Manager will also submit to the LMSB Industry Director a recommendation as to whether LMSB should proceed with the PFA request. The Case Manager should discuss, in particular, the IRS resources required (including any specialists or outside consultants), the ability to coordinate the PFA process with the examination of the taxpayer's previously filed returns, the availability of taxpayer records and personnel, and the probability of completing examination of the issue in a timely manner. If the Case Manager plans to recommend against proceeding with consideration of the PFA request, the Case Manager will discuss the proposed recommendation with the taxpayer before submitting the recommendation.

**LMSB Industry Director's Decision.** The LMSB Industry Director with jurisdiction over the taxpayer will make the final decision as to whether to proceed with the taxpayer's request towards resolution through the PFA program. Criteria for selecting taxpayers to participate in the pilot phase of the PFA program include:

- (1) The suitability of the issue presented for the program;
- (2) The direct or indirect impact of a PFA upon other years, issues, taxpayers, or related cases;
- (3) Providing a cross-section of issues and industries for the pilot; and
- (4) The probability of completing the examination of the issue and entering into a PFA by the target date.

**Communication with taxpayer.** The LMSB Industry Director or Field Operations Director will contact the taxpayer within 14 days of receipt of the request to discuss the potential suitability of the requested issue for inclusion in the pilot program. Thereafter, LMSB will inform the taxpayer in writing of LMSB Industry Director's decision to accept or reject the issue(s) for consideration in the PFA pilot program. A taxpayer is not entitled to a conference to appeal an LMSB Industry Director's decision not to go forward with the PFA process. A taxpayer not selected for the pilot program remains eligible for other procedures for early issue resolution, including the Accelerated Issue Resolution (AIR) program (see Rev. Proc. 94-67, 1994-2 C.B. 800).

## 6. PROCESSING A REQUEST FOR AN LMSB PRE-FILING AGREEMENT

**Consultation with taxpayer.** If the IRS accepts the request for consideration, the LMSB Industry Director or Field Operations Director, will contact the taxpayer to discuss scheduling an orientation program about the PFA process with the taxpayer and the audit team. This will initiate a planning process for factual development and issue resolution with respect to the issue(s) accepted for consideration. In this planning process, the IRS and the taxpayer will seek to agree on a proposed time-frame, the identification of relevant records and testimony, IRS access to records and testimony, and, ultimately, the potential scope and nature of the proposed agreement(s),

**Factual and issue development.** After acceptance by the LMSB Industry Director, the Case Manager will contact the taxpayer to discuss any questions that the IRS may have, to ask for any additional information needed to process the request, to verify data supplied, or to request additional supporting data. True copies of all contracts, agreements, instruments and other documents, as well as testimony pertaining to a request for a PFA must be submitted by the taxpayer upon request. The issues will be developed and facts confirmed consistent with auditing standards and all other applicable rules and regulations in effect regarding proper auditing techniques. The audit team will work closely with the taxpayer to resolve the issue.

**Audit Team Recommendation.** After developing the facts and issues, the Case Manager will prepare a recommendation for the LMSB Industry Director about entering into a PFA with the taxpayer. Before submitting the recommendation to the LMSB Industry Director, the Case Manager will provide the proposed recommendation to the taxpayer. If the taxpayer disagrees with the Case Manager's proposed recommendation, the Case Manager will offer the taxpayer an opportunity for a conference before submitting the recommendation to the LMSB Industry Director.

**Coordination with other functions.** In considering the request for a PFA, the LMSB Industry Director will obtain approval from, or coordinate with, all appropriate IRS functions as necessary or, in his judgment, desirable.

**Program Manager and Chief Counsel review.** The LMSB Industry Director will submit any proposed PFA to the PFA Program Manager, and through the PFA Program Manager to the Office of Chief Counsel, for review before it is executed.

**Conference with LMSB Industry Director.** If the Case Manager recommends entering into a PFA on terms agreed to by the taxpayer, but the LMSB Industry Director is tentatively unwilling to enter into such an agreement, the LMSB Industry Director will offer the taxpayer an opportunity for a conference before rejecting all or part of a

proposed PFA. In all other cases, the LMSB Industry Director is not obligated to offer the taxpayer such a conference, although the taxpayer may request one.

**Executing the PFA.** The LMSB Industry Director may execute a PFA if the LMSB Industry Director determines:

- (1) That entering into the PFA is consistent with the goals of the PFA program as stated in this Notice;
- (2) That the tax results provided for in the PFA reflect settled legal principles and correctly apply those principles (or positions authorized under Delegation Order No. 236 or 247) to the facts found by the Audit Team; and
- (3) That there appears to be an advantage in having the issue(s) permanently and conclusively closed for the taxable period covered by the PFA, or that the taxpayer shows good and sufficient reasons for desiring a closing agreement and that the United States will sustain no disadvantage through consummation of such an agreement (see § 301.7121-1(a) of the Regulations on Procedure and Administration).

**Return filing requirements not affected.** The IRS' acceptance of a taxpayer's request to attempt to reach a PFA on specified issue(s) does not suspend or waive the normal filing requirements for any tax returns that are affected by the proposed PFA. In the event that a PFA is reached prior to the filing of the return, the taxpayer will report the transaction(s) addressed in the PFA in accordance with the terms of the PFA.

**Continuation of process after filing, coordination with Accelerated Issue Resolution procedure, and Appeals.** If a PFA is not executed prior to the filing of the return(s), the IRS and the taxpayer may continue to attempt to resolve the issue and enter into a PFA under these procedures until July 31, 2001. If, as of July 31, 2001, the IRS and taxpayer have not entered into a PFA and the IRS disagrees with the taxpayer's claimed tax treatment of the transaction(s), the taxpayer and the IRS can continue the effort to reach an agreement using AIR procedures under Rev. Proc. 94-67, 1994-2 C.B. 800. This continuation of the issue resolution process does not require a new application. In addition to the AIR procedures, the taxpayer retains the right to pursue administrative appeal either by requesting an Early Referral to Appeals, or by protesting any proposed deficiency related to the issue.

## 7. WITHDRAWAL FROM THE PFA PROCESS

**Withdrawal by the taxpayer or the LMSB Industry Director.** At any time prior to the execution of the PFA by the LMSB Industry Director, either the taxpayer or the LMSB Industry Director may withdraw all or part of the request for a PFA from consideration. The withdrawal must be communicated in writing.

**Effect of withdrawal.** Notwithstanding the withdrawal by either the taxpayer or the LMSB Industry Director of any or all of the issues in the request for a PFA, the taxpayer's agreement that the inspection of records and testimony under the PFA procedures will not preclude or impede (under § 7605(b) or any administrative provisions adopted by the IRS) a later examination of a return or inspection of records with respect to any tax year needed to resolve the issue(s) in the request for a PFA, and that the IRS need not comply with any applicable procedural restrictions (such as providing notice under § 7605(b)) before beginning such examination or inspection, will remain effective.

**Availability of Early Referral to Appeals.** If the taxpayer and the IRS are unable to reach either a PFA or an AIR agreement, the possibility of forwarding the disputed issues to Appeals may be available under the Early Referral to Appeals procedures set forth in Rev. Proc. 99-28, 1999-29 I.R.B. 109.

## 8. FORM AND CONTENT OF A PRE-FILING AGREEMENT

A PFA between the taxpayer and the IRS is a closing agreement under § 7121. See Rev. Proc. 68-16, 1968-1 C.B. 770, for further information on the form and content of a closing agreement. A PFA must comply with the requirements of Rev. Proc. 68-16. The PFA will be prepared by the taxpayer and the examination team with assistance, as necessary, from the PFA Program Manager, the Office of Chief Counsel, or other IRS personnel.

## 9. DISCLOSURE

PFA's are closing agreements entered into pursuant to I.R.C. § 7121. As such, it is the position of the IRS that both PFA's and the information generated or received by the IRS during the PFA process constitute confidential return information as defined by I.R.C. § 6103(b)(2)(A), that PFA's are not written determinations under I.R.C. § 6110, and, accordingly, are exempt from disclosure to the public under the Freedom of Information Act (FOIA). However, the issue of whether certain closing agreements must be disclosed under the FOIA has been the subject of recent litigation; thus far, courts addressing this issue have agreed with the IRS position. See Tax Analysts v. IRS, 53 F.Supp. 2d 449 (D.D.C. 1999); Tax Analysts v. IRS, 1999 U.S. Dist. LEXIS 16733 (D.D.C. Aug. 6, 1999), appeal docketed, No. 5284 (D.C. Cir. Aug. 13, 1999).

## 10. MISCELLANEOUS

**Record keeping requirements.** No aspect of the PFA process will affect the record keeping requirements imposed by any section of the Internal Revenue Code.

**Record retention.** The taxpayer must maintain a copy of the PFA and supporting documents, and books of account and records sufficient to enable the IRS to examine the taxpayer's compliance with the PFA. These records may be specified in the PFA itself or in separate agreements.

## 11. PAPERWORK REDUCTION ACT

The collection of information contained in this notice has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) under the control number 1545-1684.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid OMB control number. The collections of information in this notice are in sections 4, 6, and 10. The information collected under section 4 (application) is required to provide the IRS with the information necessary to determine which taxpayers should be included in the PFA pilot program. The information collected under section 6 will be used to resolve the taxpayer's issue and to support any PFA entered into between the taxpayer and the IRS. The recordkeeping requirement under section 10 will be used for tax administration. The collections of information under sections 4 and 6 are voluntary. Once a PFA is entered into, the recordkeeping requirements under section 10 are mandatory. The likely respondents are businesses or other for-profit institutions.

The estimated total annual reporting and/or recordkeeping burden is 967 hours.

The estimated annual burden per respondent/recordkeeper varies from 5 hours to 126 hours, depending on whether a taxpayer applying to the PFA pilot program is accepted into the program. The estimated annual burden for taxpayers who apply to the PFA pilot program and are accepted is 126 hours. The estimated annual burden for taxpayers that apply to the PFA pilot program and are not accepted is 5 hours. The estimated number of taxpayers who apply to the PFA pilot program and are accepted is 7. The estimated number of taxpayers who apply to the PFA pilot program and are not accepted is 17. The estimated total number of respondents and/or recordkeepers is 24.

The estimated annual frequency of responses is on occasion.

Books or records relating to a collection of information must be retained so long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

## **12. COMMENTS**

The IRS invites interested persons to comment on this program. Send submissions to CC:DOM:CORP:R (Notice 2000-12), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions also may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (Notice 2000-12), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, interested persons may submit comments via e-mail to:

sharon.y.horn@m1.irs.counsel.treas.gov

These addresses are for comments on the pilot program. Requests by eligible taxpayers to participate in the pilot program should be submitted through their Case Manager.

## **13. FURTHER INFORMATION**

For further information regarding this Notice, contact John Petrella on (202) 283-8390 (not a toll-free number).