

IRS Refocuses on Enforcement of High-Income and High-Wealth Individuals

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In this installment of *Practically Speaking: Tax Controversy*, the authors examine the evolution of the IRS Global High Wealth Industry Group, the renewed focus on audits of high-income and high-wealth individuals, and what can be expected in that type of audit.

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On April 6, 2023, the IRS unveiled its 150-page strategic operating plan outlining the agency's plans to make fundamental changes after being funded approximately \$80 billion¹ under the Inflation Reduction Act.² The majority of the funding — approximately 60 percent — is for expanded enforcement on taxpayers with complex tax filings and high-dollar noncompliance.³ Specifically, the IRS will increase audit activity related to large partnerships, large corporations, and high-income and high-wealth (HIHW) individuals. This article focuses primarily on the IRS's initiatives on HIHW individuals.

I. A History Lesson

For many taxpayers and tax practitioners, the focus on HIHW individuals may bring about feelings of déjà vu. In 2009, the IRS created a new audit unit called the Global High Wealth Industry Group (GHWI) situated in the Large and Midsize Business Division (now the Large Business and International Division).⁴ Then-IRS Commissioner Douglas Shulman remarked that the IRS wanted:

to better understand the entire complex economic picture of the enterprise controlled by the wealthy individual and to assess the tax compliance of that overall enterprise. We cannot do this by continuing to approach each tax return in

¹ As part of the debt ceiling negotiations earlier this year, \$1.4 billion was rescinded, and the Biden administration has agreed to repurpose an additional \$20 billion in 2024 and 2025.

² IR-2023-72; IRS, "Internal Revenue Service Inflation Reduction Act Strategic Operating Plan FY2023-2031" (Apr. 5, 2023).

³ The IRS has pledged not to increase audit rates relative to historical levels for small businesses and households earning \$400,000 or less.

⁴ In August 2010, the IRS announced it had realigned LMSB and renamed it LB&I. IR-2010-88.

the enterprise as a single and separate entity. We must understand and analyze the entire picture.⁵

The GHWI team, referred to by some as the “Wealth Squad,” was formed to centralize operations and conduct examinations in a manner similar to LB&I audits. That is, each audit team would consist of revenue agents and specialists with expertise in flow-through entities, international tax, valuation matters, and relevant industries. The audit would not be limited to the individual’s Form 1040 but would take a holistic approach by looking at all related entities, including trusts, flow-through entities, privately held corporations, private foundations, and real estate investments. In other words, the GHWI team would look to the complete financial picture of the individuals and the enterprises they control.

The IRS formulated an initial information document request to use in these audits. Applying a kitchen sink approach, the initial IDR asked for substantial information regarding the individual and all related entities.⁶ Unsurprisingly, many taxpayers and practitioners objected to the overbreadth of the initial IDR, raising concerns regarding the time and resources required to fully respond. The IRS ultimately relented, acknowledging that it had “taken strides to make sure it doesn’t happen again.”⁷

In 2015, the Treasury Inspector General for Tax Administration issued a report advising the IRS to reevaluate the GHWI initiative.⁸ Specifically, the TIGTA report found that the IRS devoted almost half its audit resources to taxpayers in the \$200,000 to \$399,000 income

category and had not established the GHWI group as a stand-alone function capable of conducting all its own examinations. The TIGTA report recommended the IRS: (1) reevaluate income thresholds; (2) conduct a cost-benefit analysis of the GHWI outsourcing initiative; (3) explore system modifications to quantify examination results; (4) ensure that management reports accurately reflect that there was no audit quality measure; (5) establish a permanent ongoing quality review system; and (6) require quality reviews for closed cases. The IRS agreed with all except recommendations 2 and 3.

By some accounts, the initial GHWI program did not produce the expected results.⁹ But the IRS has not abandoned its efforts.

In July 2019, LB&I announced the high-income nonfiler initiative. That campaign, which is part of the IRS’s shift to issue-based examinations,¹⁰ stated:

U.S. citizens and resident aliens are subject to tax on worldwide income. This is true whether or not taxpayers receive a Form W-2 Wage and Tax Statement, a Form 1099 (Information Return) or its foreign equivalents. Through an examination treatment stream, this campaign will concentrate on bringing into compliance those taxpayers who have not filed tax returns.

Several months later the COVID-19 pandemic hit, causing a pause in examination activity. Under the People First Initiative announced in April 2020, the IRS said that it would not start new field, office, or correspondence examinations between April 1 and July 15, 2020.¹¹ In June 2020, however, the IRS announced that it would move to start the examination of several hundred high-income individuals between July 15 and

⁵ IR-2009-116; see also “Prepared Remarks of IRS Commissioner Douglas H. Shulman Before the AICPA National Conference on Federal Taxation” (Oct. 26, 2009) (“For a variety of reasons — including valid business reasons — many high wealth individuals make use of sophisticated financial, business, and investment arrangements with complicated legal structures and tax consequences. Many of these arrangements are entirely above board. Others mask aggressive tax strategies.”).

⁶ For more background on the “kitchen sink” IDR, see Charles P. Rettig, “IRS High-Wealth Industry Group: Evaluation of Wealth Squad IDR,” *Tax Notes*, Nov. 1, 2010, p. 607.

⁷ Shamik Trivedi, “LB&I’s Global High-Wealth Industry Group Learning From Mistakes,” *Tax Notes*, Mar. 4, 2013, p. 1048.

⁸ TIGTA, “Improvements Are Needed in Resource Allocation and Management Controls for Audits of High-Income Taxpayers,” 2015-30-078 (Sept. 18, 2015).

⁹ See, e.g., Steven Miller (former LB&I commissioner), “Audits From Hell: The Return of Global High Wealth Audits,” *alliantNational* blog (July 17, 2020) (“To understand and appropriately scrutinize such a web [of entities that wealthy families operate], it was determined that we needed to build teams of specialists, including partnership specialists, trust and private foundation specialists, and others. New tools were developed that I am quite sure have been improved on in my time away. I will say that the depression of IRS resources caused a delay in the full roll out of our intended path.”).

¹⁰ A list of LB&I’s active campaigns can be found on the IRS’s website.

¹¹ IR-2020-59.

September 30, 2020.¹² Further, the IRS identified over 1,000 private foundations linked to global high-wealth enterprises and identified a compliance strategy for private foundations.¹³ Finally, since 2020, LB&I has emphasized its focus on HIIHW individuals in Publication 5319, “LB&I Strategic Goals.”¹⁴

While the audit rates for individuals with taxable income of \$1 million or more has trended downward from calendar years 2010 through 2020,¹⁵ the recent IRS strategic operating plan outlines the agency’s plans to make fundamental changes following the appropriation of billions of dollars in IRA funding. Further, because the most recent IRS data book looks only to examinations as of September 30, 2022, many examinations for 2020 commencing in late 2022 and through early 2023 have not been captured. Finally, some of the wealthiest individuals may sustain overall losses for certain tax years, for a variety of reasons, and therefore may not have been reflected in the recent data population, which looks to income rather than assets.

II. Back to the Future

The IRA gave the IRS additional funding to renew its focus on HIIHW individuals. As noted, the IRS specifically identified its intention to expand enforcement efforts in that area. IRS Commissioner Daniel Werfel reiterated this point in his comments to the House Ways and Means Committee last spring:

Our compliance efforts will focus on complex issues and high-dollar noncompliance. This is important, because over the past several years, our ability to enforce the tax laws against non-compliant taxpayers with complex returns

— including large corporations, complex partnerships, and high-wealth individuals — has been hampered by a lack of resources. We have been unable to audit a reasonable percentage of these groups, and we are often limited in the issues reviewed among those we do audit. Many of these taxpayers can afford to spend large amounts to drag out proceedings unnecessarily or bury the government in paper, leaving us unable to assure a reasonable degree of compliance with the laws passed by Congress.

Funding provided under the IRA will allow us to hire and train more specialists across a wide range of complex areas needed to assist with the audits of the complex issues we will be focusing on. For example, we will focus the IRA enforcement resources on hiring the accountants, attorneys, engineers, economists, and data scientists needed to pursue high-income and high-wealth individuals, complex partnerships, and large corporations that are not paying the taxes they owe. Using improved data and analytics, we will enhance detection of noncompliance and increase enforcement activities for such high-risk and novel emerging issues as digital assets, listed transactions, and certain international tax issues. All of this will be done with an eye toward fairness and always respecting taxpayer rights.¹⁶

More recently, in a press release in August on the IRA one-year report card, the IRS singled out its efforts regarding HIIHW individuals, both in the civil and criminal contexts.¹⁷

Moreover, in September the IRS announced the start of a “sweeping, historic effort” to shift its

¹²Nathan J. Richman, “IRS to Start Hundreds of Global High-Wealth Exams in July,” *Tax Notes Federal*, June 22, 2020, p. 2162.

¹³*Id.*

¹⁴Compare Publication 5319 for fiscal 2023 (rev. Oct. 2022) (noting goal of increasing LB&I’s “work in the areas of pass-throughs and high income/high wealth to reduce the tax gap and effect greater fairness access across all taxpayer groups”) and KPMG TaxNewsFlash No. 2020-640 (Oct. 9, 2020) (noting LB&I’s goal of expanding “coverage of pass-through entities, high-wealth taxpayers, and high-income individuals”) with Publication 5319 for fiscal 2019 (rev. Feb. 2019) (not specifically identifying HIIHW individual compliance as an area of focus).

¹⁵2020 IRS Data Book (covering Oct. 1, 2019, to Sept. 30, 2020).

¹⁶Written Testimony of Daniel Werfel Commissioner Internal Revenue Service Before the House Ways and Means Committee on the Filing Season and the IRS Budget” (Apr. 27, 2023).

¹⁷IR-2023-148. In the press release, the IRS noted that in recent months it had closed about 175 delinquent tax cases for millionaires, generating \$38 million in recoveries. See also IR-2023-194 (reaffirming the IRS’s commitment to HIIHW audits and noting examples of recent cases closed since the IRA was passed).

attention to high-income earners and partnerships, as well as large corporations.¹⁸ Building on its success with the 175 delinquent tax cases mentioned in the August press release, the IRS indicated that it will be assigning dozens of revenue officers to “high-end collection cases” that will focus on the collection of outstanding taxes from 1,600 high-income taxpayers with total income above \$1 million and more than \$250,000 in recognized tax debt. Further, in the audit context, the IRS said it will use enhanced technology and artificial intelligence to improve case selection and the agency’s detection of compliance threats in connection with HIIHW taxpayers and partnerships. The announcement identified certain priority areas for its compliance work for fiscal 2024, including expanded compliance enforcement efforts on (1) digital assets (an initial review showed the potential for a 75 percent noncompliance rate from digital currency exchanges); (2) foreign bank account report violations (the IRS has identified hundreds of possible FBAR nonfilers with account balances that average over \$1.4 million, and it intends to audit the most egregious non-file FBAR cases); and (3) labor brokers (the IRS plans civil audits and criminal investigations targeting construction contractors making reportable payments to subcontractor shell companies in an effort to avoid tax).

HIIHW examinations involve not only an examination of the individual’s tax return but also an examination of one or more entities in which the individual has a controlling interest (directly, indirectly, or by attribution). These audits may involve examinations of partnerships, trusts, subchapter S corporations, C corporations, private foundations, and gift tax or estate returns. Thus, initiatives regarding these types of entities, whether in the form of LB&I campaigns or an increased focus on partnerships audits, add to the increased scrutiny of certain HIIHW individuals.

To accomplish its increased enforcement goals, the IRS has been actively recruiting and hiring more personnel in the enforcement area.¹⁹ It was recently announced that the IRS is seeking to hire 3,700 revenue agents — enforcement personnel who typically focus on audits — to expand enforcement around HIIHW individuals, partnerships, large corporations, and promoters.²⁰ And the IRS is tripling the size of its GHWI program by expanding from two regional offices to six.²¹ Thus, the expectation is that audit rates for the HIIHW population will continue to increase.

III. Navigating HIIHW Audits

Now that the IRS is back in the saddle on HIIHW audits, questions abound for potentially affected taxpayers and their advisers. These include questions such as (1) how a taxpayer is selected for examination; (2) what the likely areas of focus are; and (3) how one can best prepare for and respond to an HIIHW audit.

A. Selection Criteria and Exam Procedures

The Internal Revenue Manual provides insight into how the IRS executes HIIHW audits — specifically, audits managed by the GHWI team.²² The LB&I assistant deputy commissioner compliance integration (ADCCI) has primary responsibility for overall coordination and workload identification. The selection process is explained as follows:

ADCCI utilizes computations to determine the examination potential of the enterprises controlled by high wealth individual taxpayers. These computations were developed from Compliance Data Warehouse data and are used to preliminary assess the level of compliance risk on filed (or unfiled) returns. ADCCI then provides WLS [Workload Services] with an initial listing of the high wealth

¹⁹ See Lauren Loricchio, “IRS Turns to Contractors for Hiring and Recruiting Help,” *Tax Notes Federal*, July 24, 2023, p. 616.

²⁰ IR-2023-172.

²¹ Wesley Elmore, “IRS Tripling Size of Its Global High-Wealth Group,” *Tax Notes Federal*, Oct. 30, 2023, p. 907 (discussing need to increase size of program and noting recent hiring of approximately 100 mid-career professionals).

²² IRM 4.52.1.

¹⁸ IR-2023-166.

taxpayer population with risk scores. The returns with the highest risk indicators are further risk assessed by WLS and potentially result in the enterprise being selected for GHW examination.²³

The IRS has not publicly disclosed what computations are used to determine compliance risk levels for these audits. By all accounts, the IRS will be leaning more into data analytics in its enforcement efforts. In the strategic operating plan released in April, the IRS provided its view that risk analytics have been underutilized to date.²⁴ For HIHW individuals in particular, the IRS hopes data analytics will allow the agency to select returns with the highest risk of noncompliance and identify the most optimal intervention to address potential noncompliance (for example, audits or other nontraditional compliance treatments, such as soft letters, that are meant to prompt taxpayers into compliance).²⁵ Given potential resource constraints and the IRS's desire to make better use of data in its decision-making, the IRS Office of Research, Applied Analytics, and Statistics indicated in a July 6 draft performance work statement that it was seeking commercial consulting services to assist the IRS with, among other things, harnessing data to reduce noncompliance through audits and other treatment streams.²⁶

In addition to high-risk taxpayers identified through ADCCI, the inventory of taxpayers selected for HIHW examinations is supplemented by referrals from field agents, whistleblower claims, and specific issues on a return appearing to significantly affect the global high-wealth population.²⁷ Once an HIHW individual is identified, a detailed risk assessment process is conducted that consists of researching taxpayer forms and related data, identifying specific issues, observing trends, and consulting with industry and other tax specialists. As a part of the WLS risk assessment, a HIHW individual's return forms,

statements, and Schedules K-1 are all reviewed to obtain an understanding of the taxpayer's enterprise and identify large, unusual, or questionable items. Once a case is assigned, a virtual case folder is established to house case-building items, examination workpapers, and examination-related materials. For example, all IDR responses, whether received electronically or in paper form, are scanned onto the shared drive. This virtual housing allows IRS personnel in different geographic locations to work on a case — a practice that is becoming increasingly common. The examination team, similar to corporate examinations by LB&I, may consist of several members with expertise in areas such as international, partnerships, and estate and gift tax, as well as industry specialists, economists, and appraisers.

HIHW examinations will often involve partnership examinations of enterprise entities subject to the centralized partnership audit regime created under the Bipartisan Budget Act of 2015. Accordingly, an understanding of the BBA audit procedures can be important.²⁸ BBA rules provide for a partnership representative that has sole authority to act on behalf of and bind the partnership during a BBA audit proceeding.²⁹ In addition to special procedures at the outset of the examination, if there are proposed adjustments, the BBA adds a layer of complexity in terms of resolving the examination, pursuing administrative appeals, and making certain requests for modification. Another complexity is in electing to push-out adjustments to the partners for the period under review, in lieu of the default rule that the partnership pays any imputed underpayment amount, as well as any interest and penalties that may apply. A discussion of BBA audit procedures is beyond the scope of this article; however, HIHW taxpayers need to be aware of them in the event an HIHW

²³ IRM 4.52.1.2(2).

²⁴ IRS strategic operating plan, *supra* note 2.

²⁵ *Id.*

²⁶ Loricchio, "IRS Seeks Outside Help in Applying Big Data," *Tax Notes Federal*, July 17, 2023, p. 444.

²⁷ IRM 4.52.1.4(1).

²⁸ In general, a partnership is subject to the BBA examination procedures unless the partnership opts out on a timely filed return. Section 6221(a). However, the election out of the BBA is available only if the partnership has fewer than 100 partners and all those partners are individuals, C corporations, foreign entities that would be treated as C corporations were they domestic, S corporations (although the number of shareholders counts toward the 100 partners at the partnership level), or estates of deceased partners. Section 6221(b)(1) and (2).

²⁹ Section 6222.

examination expands to include an enterprise entity subject to the BBA rules.³⁰

B. Potential Areas of Focus

There are several potential areas of focus in an HIHW audit, including the following.

1. Reportable transactions and campaigns.

Examples of areas of focus include syndicated conservation easements, microcaptive insurance, partnership and S corporation issues (distributions and losses exceeding basis), Self-Employment Contribution Act tax, virtual currency, and offshore private banking. The IRS continues to focus on transactions determined to be or that have the potential to be abusive — specifically, listed transactions and transactions of interest.

2. Schedule C or passthrough losses.

Examples include “hobby” losses, such as horse racing or breeding and private airplane and yacht charters.³¹ Entities that have sustained losses over several years that reduce or offset income of an individual are a common target in HIHW examinations. However, extraordinary losses (that is, a potential large, unusual, or questionable item) from a flow-through entity even for a single year can be an item of targeted review. An example of this latter scenario might be a capital-intensive business activity that generated large bonus depreciation expense deductions.

3. Material participation.

It is common at the outset of HIHW examinations for the IRS to review a taxpayer’s application of passive activity loss limitations under section 469 and whether certain entities within the taxpayer’s enterprise are involved in per se passive activities.³² The more entities and industries there are within an enterprise, the more this item of review can heighten.

³⁰ For an introduction to the BBA audit procedures, the IRS has made available on its website: “BBA Partnership Audit Process.” See also IRS Publication 5338, “Bipartisan Budget Act (BBA) Roadmap for Taxpayers” (June 2020).

³¹ See IRS Audit Technique Guide, “Activities Not Engaged in for Profit” (Sept. 2021).

³² See IRS Audit Technique Guide, “Passive Activity Loss” (Feb. 2005).

4. Foreign-source income and assets, including financial accounts, foreign retirement accounts, and foreign trusts.

As noted earlier, the IRS is seeking to actively initiate FBAR examinations targeting egregious nonfilers and individuals who use foreign accounts to avoid the disclosure of offshore assets. There are large penalties for failure to file Form 3520, “Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts”; Form 3520-A, “Annual Information Return of Foreign Trust With a U.S. Owner”; Financial Crimes Enforcement Network Form 114, “Report of Foreign Bank and Financial Accounts (FBAR)”;³³ and Form 8938, “Statement of Specified Foreign Financial Assets.” Those penalties substantially increase if the failure is willful or ongoing. Accuracy-related penalties and civil and criminal fraud penalties could also arise in the context of a failure to properly report income related to foreign accounts and assets.

5. Private foundations.

As discussed above, the IRS is interested in the use of private foundations by HIHW taxpayers. Areas of scrutiny include self-dealing issues, related-party transactions, contributions to nonpublic charities, and trustee and employee compensation.

6. Charitable contributions.

In this context, substantiation and valuation are often the key items examined, as well as any contributions related to conservation easements.³⁴ The IRS recently warned HIHW taxpayers against promotions involving exaggerated art donation deductions.³⁵ The agency said it will use a variety

³³ Taxpayers should be aware that revenue agents must follow special procedures when opening a title 31 investigation of an individual or entity’s FBAR filings if they have started from a title 26 income tax examination. See IRM 4.26.17.2 and 4.26.17.2.1. FBARs are required filings under the Bank Secrecy Act (title 31); however, the Treasury secretary delegated (from FinCEN) to the IRS the authority to enforce FBAR filing and recordkeeping requirements, investigate possible violations, and assess and collect associated civil penalties. See IRM 4.26.1-2.

³⁴ See, e.g., IRS Publication 526, “Charitable Contributions” (Feb. 2013); IRS Publication 561, “Determining the Value of Donated Property” (Jan. 2023); IRS Publication 1771, “Charitable Contributions — Substantiation and Disclosure Requirements” (Mar. 2016); IRS Publication 4303, “A Donor’s Guide to Vehicle Donation” (Jan. 2015); and Notice 2004-7, 2004-1 C.B. 310 (dealing with charitable contributions of patents and other intellectual property).

³⁵ IR-2023-185.

of compliance tools to combat abusive art donations, including audits and civil penalty investigations. In its warning, the IRS took the opportunity to note that it is focused on increasing compliance efforts on HIHW individuals to ensure filers pay the right amount of tax owed.³⁶

7. Meals and entertainment.

The IRS investigates whether claimed expenses for meals and entertainment are directly related to the active conduct of the taxpayer's trade or business and are ordinary and necessary. Specific substantiation rules apply for entitlement to claimed deductions.³⁷

8. Business versus personal expenses.

The initial interview portion of the opening conference for selected enterprise entities will include questions about whether there are any aircraft, watercraft, or vehicles held by the entity and used in its trade or business and whether those assets are available for the personal use of the HIHW individual. These inquiries may also include questions about whether the entity has real property or leased properties subject to personal use by the HIHW individual.

9. Related-party transactions.

The IRS will inquire about any contracts, agreements, or transactions between related parties in the HIHW individual's enterprise. The IRS has noted that the complexity of passthrough structures and the potential for shifting or circular flows in closely held enterprises are an area of particular concern.³⁸

10. Gifts and bequests made or received.

The IRS will investigate any large gifts or bequests to ensure that proper reporting requirements have been met. Further, for noncash transfers, valuation may become an area of focus.

C. Taxpayers' Preparation and Response

The key to effectively resolving an IRS examination often comes down to substantiation.³⁹ Thus, HIHW taxpayers should ensure that they have access to the necessary documentation to support their tax reporting positions. Common items the IRS may request in an HIHW audit include:

- federal tax returns for all open years (before and after the years under audit) for the individual and all related entities;⁴⁰
- other tax returns (for example, gift and estate returns);
- Schedules K-1 and workpapers with reconciliations;
- tax basis calculations for partnerships and S corporations;⁴¹
- organizational charts (domestic and foreign) of all related entities (direct, indirect, and by the attribution rules);
- an explanation of the business activities of each entity identified in the taxpayer's enterprise organizational chart;
- bank account information (account statements, bank reconciliations, etc.);
- general ledger, trial balances, and financial statements (audited or unaudited);
- receipts and invoices for material expenses;
- valuations and appraisal reports (nonmonetary charitable contributions, conservation easements, property transfers, etc.); and
- related-party loan documents.

³⁶ *Id.*; see also Hale E. Sheppard, "IRS Attacks on Art Donations; Old Techniques, New Hurdles," *Tax Notes Federal*, Nov. 13, 2023, p. 1221 (discussing the IRS's recent focus on artwork donation schemes and the hurdles it may face in applying the economic substance doctrine).

³⁷ See, e.g., section 274(d).

³⁸ IR-20123-176.

³⁹ See section 6001 ("Every person liable for any tax imposed by this title, or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe. Whenever in the judgment of the Secretary it is necessary, he may require any person, by notice served upon such persons or by regulations, to make such returns, render such statements, or keep such records, as the Secretary deems sufficient to show whether or not such person is liable for tax under this title.").

⁴⁰ The IRS will note that these returns are solicited for comparison purposes, even though the other periods are not under examination.

⁴¹ LB&I has several campaigns centering on losses claimed in excess of basis or excess distributions. See *supra* note 10.

D. IDRs in HIHW Audits

Because HIHW audits are administered under the LB&I examination process, the exam team will follow the LB&I requirements for issuing an IDR.⁴² Under LB&I IDR issuance procedures, the IRS will provide issue-focused IDRs in draft format and discuss the contents with the taxpayer. Taxpayers are strongly encouraged to be engaged in this process to ensure the necessary documentation is targeted, in accordance with the purpose of the IDR, in the most efficient manner and to avoid unnecessary follow-up requests or misunderstandings. Many HIHW audits involve family offices with limited resources. Efficient audit administration is a practical means of managing taxpayer resource constraints. Moreover, communication in the draft stage of an IDR allows the taxpayer to have input on due dates for the response and can otherwise avoid additional burdens relative to IDR enforcement processes.

As noted in Section III.C., there are common areas and issues targeted for review in HIHW audits. Having an audit-ready file that captures much of the related documentation, to the extent relevant to the individual and their enterprise entities, can further reduce the burdens that may be associated with responding to IDRs.

E. Third-Party Contacts, Best Practices

The IRS's procedure is to generally work with a taxpayer under audit to gather information relevant to income tax returns under examination. The IRS's policy is to minimize its third-party contacts. However, the IRS may determine that a third-party contact is necessary to obtain information that the taxpayer has been unable to provide or to verify information that the agency has received. A third-party contact is a communication that (1) is initiated by an IRS employee; (2) is made to a person other than the taxpayer; (3) is made regarding the determination or collection of the tax liability of that taxpayer; (4) discloses the identity of the taxpayer being investigated; and (5) discloses the IRS employee's association with the agency.⁴³

⁴²IRM 4.46.4-1.

⁴³Section 7602(c); reg. section 301.7602-2(b).

The Taxpayer First Act of 2019⁴⁴ revised section 7602 to require that the IRS take certain steps before making a third-party contact. Namely, the IRS is prohibited from making a third-party contact without providing reasonable advance notice to the taxpayer.⁴⁵ This usually will take the form of IRS Letter 3164-E or a similar notice. Also, the IRS must periodically give the taxpayer a record of persons contacted.⁴⁶ These records must also be provided upon request of the taxpayer.⁴⁷ Because the IRS may not issue a record of persons contacted until well after the conclusion of the period covered by the notice, the taxpayer may want to develop a process whereby a listing of third-party contacts is regularly made during the period specified in the IRS's advance notice of its intent to make third-party contacts (for example, at least quarterly).⁴⁸

IV. Conclusion

Increased funding and recent IRS press releases, coupled with events set in motion coming out of the COVID-19 pandemic, indicate that the IRS is refocusing on enforcement of HIHW individuals. Taxpayers within this targeted population may want to consider proactive steps now to ensure readiness if an audit is commenced.⁴⁹ ■

⁴⁴Section 1206 of the act.

⁴⁵Section 7602(c)(1); reg. section 301.7602-2(a).

⁴⁶Section 7602(c)(2).

⁴⁷*Id.*; reg. section 301.7602-2(a) and (e)(1).

⁴⁸Circumstances may merit more immediate requests for third-party contact information.

⁴⁹The foregoing information is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the author(s) only and does not necessarily represent the views or professional advice of KPMG LLP.

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