



# MANUAL TRANSMITTAL

Department of the Treasury  
Internal Revenue Service

4.46.4

SEPTEMBER 6, 2023

## EFFECTIVE DATE

(09-06-2023)

## PURPOSE

- (1) This transmits revised IRM 4.46.4, LB&I Examination Process, Executing the Examination.

## SCOPE

- (1) Examinations vary in scope, size, and complexity; therefore, portions of this IRM may be more applicable to some cases than others.

## MATERIAL CHANGES

- (1) IRM 4.46.4.1.1, Background: removed outdated reference.
- (2) IRM 4.46.4.7.3 updated to exclude Micro Captive and Syndicated Conservation Easement cases from IDR Enforcement Process.
- (3) Interim guidance memoranda were incorporated into the IRM as shown in the table below:

IRM Section	Incorporated Interim Guidance Control Number	Interim Guidance Title
4.46.4.2	LBI-04-0423-0004	Interim Guidance for Approval of Penalties under Internal Revenue Code (IRC) 6751(b)(1) for LB&I Examinations
4.46.4.12.1	LBI-04-0423-0004	Interim Guidance for Approval of Penalties under Internal Revenue Code (IRC) 6751(b)(1) for LB&I Examinations
4.46.4.12.2	LBI-04-0423-0004	Interim Guidance for Approval of Penalties under Internal Revenue Code (IRC) 6751(b)(1) for LB&I Examinations
4.46.4.12.6	LBI-04-0423-0004	Interim Guidance for Approval of Penalties under Internal Revenue Code (IRC) 6751(b)(1) for LB&I Examinations

<b>IRM Section</b>	<b>Incorporated Interim Guidance Control Number</b>	<b>Interim Guidance Title</b>
4.46.4.12.9	LBI-04-0422-0014	Interim Guidance Memorandum on Economic Substance Doctrine and Related Penalties
Exhibit 4.46-4	LBI-04-0422-0014	Interim Guidance Memorandum on Economic Substance Doctrine and Related Penalties

- (4) Hyperlinks updated throughout.
- (5) Editorial changes made throughout.

#### **EFFECT ON OTHER DOCUMENTS**

This IRM incorporates Interim Guidance Memoranda LBI-04-0423-0004, Interim Guidance for Approval of Penalties under Internal Revenue Code (IRC) 6751(b)(1), dated April 27, 2023, and LBI-04-0422-0014, Interim Guidance on Economic Substance Doctrine and Related Penalties, dated April 22, 2022. IRM 4.46.4 dated September 23, 2021 is superseded.

#### **AUDIENCE**

All LB&I personnel

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4.46.4

Executing the Examination

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4.46.4.1  
(09-23-2021)  
**Program Scope and Objectives**

- (1) **Purpose:** This IRM section describes the execution phase of the LB&I Examination Process. Specifically, IRM 4.46.4:
  - a. Describes the process to implement audit steps
  - b. Establishes policies and procedures to gather information, research federal tax law and issue Notices of Proposed Adjustment
  - c. Establishes policies and procedures for the application of Economic Substance Doctrine and penalties
  - d. Establishes procedures for the IDR enforcement process
  - e. Provides guidelines for monitoring and managing cases
  - f. Provides guidelines for monitoring and developing issues
  - g. Provides guidelines for issuing an Acknowledgment of Facts IDR for potentially unagreed issues
- (2) **Audience:** All LB&I personnel
- (3) **Policy Owner:** Assistant Deputy Commissioner Compliance Integration (ADCCI)
- (4) **Program Owner:** The LB&I Policy Office within ADCCI.
- (5) **Primary Stakeholders:** LB&I executives, senior managers, frontline managers, examiners, program analysts and paraprofessional staff.

4.46.4.1.1  
(09-06-2023)  
**Background**

- (1) The LB&I Examination Process, as discussed in Publication 5125, changed the way in which LB&I examinations are conducted. Examinations are now divided into three phases: planning, execution, and resolution. The execution phase is discussed here.

4.46.4.1.2  
(12-13-2018)  
**Authority**

- (1) See IRM 4.46.1.1.2, Authority.

4.46.4.1.3  
(12-13-2018)  
**Responsibilities**

- (1) See IRM 4.46.1.1.3, Roles and Responsibilities.

4.46.4.1.4  
(09-23-2021)  
**Program Management and Review**

- (1) See IRM 4.46.1.1.4, Program Management and Review.

4.46.4.1.5  
(12-13-2018)  
**Terms/Definitions/ Acronyms**

- (1) See IRM Exhibit 4.46.1-1, Glossary of LB&I Terms.

4.46.4.1.6  
(09-23-2021)  
**Related Resources**

- (1) The LB&I intranet sites <https://irsgov.sharepoint.com/sites/LBI> and <https://irsgov.sharepoint.com/sites/ETD-KMT-KB051> are resources for learning more about the concepts and procedures in this section. Type key words in the search box on the LB&I home page or virtual library for more information about a specific item.

4.46.4.2  
(09-06-2023)  
**Overview of the  
Execution Phase**

- (1) The audit steps for each issue selected in the examination plan are implemented during the execution phase. Issue teams will develop each issue by gathering the relevant facts through continued mutual transparency and cooperation with the taxpayer. The depth and the scope of each issue examined is a matter of professional judgment. The documents examined and the conclusions reached must be recorded in the workpapers.
- (2) A cooperative and transparent taxpayer will assist in the factual development of each issue as described in Publication 5125, LB&I Examination Process. The primary method of obtaining information is through issuing Form 4564, Information Document Request (IDR). IDRs are required to be issue-focused and contain a statement of the issue. A discussion with the taxpayer and/or their representative is required to confirm an understanding of the items requested and to set a reasonable response date for the request.

**Exception:** IDRs issued at the beginning of an examination to request basic books and records and general information about a taxpayer's business are not subject to the requirement to state an issue.

**Reminder:** The Initial Transfer Pricing Documentation IDR response time is 30 days, as codified by law. For additional guidance, see IRM 4.46.4.7.2 and IRM 4.61.3, Development of IRC 482 Cases.

- (3) Each issue team will conduct continuous, interactive discussions to ascertain whether to continue or modify examination procedures and to resolve any factual or legal differences as IDR responses are reviewed.
- (4) The progress of the examination will be collaboratively monitored by the case manager and the issue manager(s). Penalties should be considered concurrently with the development of the substantive issues, and the assertion or non-assertion of any applicable penalties should also be fully explained and documented in the workpapers and/or penalty lead sheets. A penalty lead sheet (currently SAIN 011) is used to approve penalty assertions and for the non-assertion of a substantial understatement penalty when it is statutorily applicable under IRC 6662(d) and for the non-assertion of the erroneous claim for refund or credit penalty when a substantial portion of the claim for refund or credit is disallowed. Managerial approval of penalties must be documented in writing by the immediate supervisor of the employee asserting a penalty, or such higher-level official as the Secretary may designate. The case manager is designated as such higher-level official. Refer to IRM 4.46.4.12.2.
- (5) For potentially unagreed issues, the issue team is required to solicit an acknowledgment of facts by attaching a draft Form 886-A, Explanation of Items, to the acknowledgment of facts (AOF) IDR to request the taxpayer's concurrence on the facts. The issue team should resolve any factual differences and/or document all disputed facts. The issue team will then apply the law to the complete set of facts in a fair and impartial manner when preparing the final Form 886-A. The issue manager should ensure that all relevant facts, including additional and/or disputed facts, are appropriately considered before signing and issuing the Form 5701, Notice of Proposed Adjustment (NOPA).
- (6) Before issuing a NOPA, the issue team must discuss LB&I's tax position with the taxpayer and explain the law applied in making each determination. The issue team should also work with the taxpayer to set a NOPA response date. If

an agreement is not reached, then the issue team will set a reasonable response date. A standard response time can be established in the examination plan for all NOPAs.

- (7) The NOPA must be signed by the issue manager prior to issuing to the taxpayer.

## 4.46.4.3 (03-09-2016) **Examination Techniques Used to Gather Evidence**

- (1) In addition to the audit steps outlined in the exam plan, the issue team(s) may consider other appropriate examination techniques used to gather evidence:
  - a. Interviews (IRM 4.10.3.4)
  - b. Tours of business sites (IRM 4.10.3.5)
  - c. Sampling techniques (IRM 4.10.3.14)
  - d. Balance sheet analysis (IRM 4.10.3.10)
  - e. Analysis of Schedules M-1, M-2 and M-3 (IRM 4.10.3.8)
- (2) Refer to IRM 4.46.3.8.1.2.1, Examples of Audit Steps.
- (3) Additional balance sheet analysis information can be found in IRM 4.10.4.3.4.1, Balance Sheet Analysis (Corporations and Other Business Returns), and IRM Exhibit 4.10.3-3, Balance Sheet Examination Techniques.
- (4) Additional information about analyzing Schedules M-1, M-2 and M-3 can be found in IRM 4.10.4.3.4.2, Schedules M-1, M-2, and M-3 (Corporation and Other "Business" Returns).

## 4.46.4.3.1 (12-13-2018) **Interviews**

- (1) IRC 7602 authorizes the Secretary or a delegate to examine books and records and to take testimony under oath.
- (2) Interviews are used to develop facts and establish evidence. Interviews should be tailored to the taxpayer and the issues under consideration. Should the taxpayer not cooperate in an interview, issues may be developed through the testimony of witnesses. The record of interviews can take one of the following forms:
  - a. Transcript of interview
  - b. Question-and-answer statement
  - c. Affidavit
  - d. Memorandum of interview
  - e. Audio recording – See IRM 25.5.5.4.4, Right to Make an Audio Recording of the Proceeding.
- (3) For procedures regarding documenting interviews, see IRM 4.10.3.4.6, Documenting Interviews.

## 4.46.4.3.2 (09-23-2021) **Tours of Business Sites**

- (1) Treas. Reg. 301.7605-1(d)(3)(iii) states: "regardless of where an examination takes place, the Service may visit the taxpayer's place of business to establish facts that can only be established by direct visit, such as inventory or asset verification. The Service generally will visit for these purposes on a normal workday of the Service during the Service's normal tour of duty hours." See IRM 4.10.3.5, Tours of Business Sites and Inspection of Residences.
- (2) Tours of business sites are not required, but are recommended if geography and circumstances allow. Generally, the principal location and any locations acquired during the period under examination should be visited. Any tours of

business sites conducted should be described and documented in the workpapers. If a tour of the business site is not conducted, the reason(s) should be documented in the workpapers. See IRM 4.10.3.5.6, Case File Documentation.

- (3) If a tour of business site is warranted and the issue team member(s) are not in a geographic proximity to the business site, consideration should be given to requesting assistance and support from local IRS personnel.

4.46.4.3.3  
(12-13-2018)  
**Sampling Techniques**

- (1) Computer Audit Specialist (CAS) assistance must be requested for issues involving statistical sampling whether originated by the IRS or by the taxpayer.
- (2) There are two basic types of sampling: judgment and statistical.
  - a. Judgment sampling requires examiners to use professional judgment in performing the sampling procedure and in evaluating the results of the sample.
  - b. Statistical sampling is a procedure used to choose a portion of the whole to make a statement about the entire population. Other terms applied to statistical sampling include probability sampling and random sampling. See Rev. Proc. 2011-42.

4.46.4.4  
(12-13-2018)  
**Researching Federal Tax Law**

- (1) LB&I examiners must consider the various legal authorities and guidance available to them when developing and resolving issues. Some of these include:
  - a. Internal Revenue Code (IRC)
  - b. Committee Reports
  - c. Treasury Regulations
  - d. Revenue Rulings
  - e. Revenue Procedures
  - f. Delegation Orders (DO)
  - g. Private Letter Rulings (PLR)
  - h. Technical Advice Memoranda (TAM)/Chief Counsel Advice (CCA)
  - i. Court Opinions
  - j. Tax Treaties
- (2) IRM 4.10.7, Examination of Returns, Issue Resolution, provides a detailed explanation of each of these sources and the format for citing them in reports.
- (3) The use of IRS contracted subscription internet services is recommended to perform electronic tax research (e.g., Westlaw, Bloomberg Tax or Accurant).

4.46.4.5  
(12-13-2018)  
**Using Technical Expert Resources**

- (1) During the execution phase, examiners must develop issues using the appropriate examination techniques and determine the correct tax liability. Where appropriate the issue team should consult with a subject matter expert (SME), Counsel and/or other technical experts. Based on the facts and circumstances, examiners must also correctly research, interpret and apply the law in a fair and impartial manner and consider congressional intent.
- (2) The issue team is strongly encouraged to consult with an SME as technical questions arise. See IRM Exhibit 4.46.1-1, Glossary of LB&I Terms, for the definitions of the terms "subject matter expert" and "practice network".



4.46.4.6  
(09-23-2021)  
**Referral to Tax  
Exempt/Government  
Entities (TE/GE)**

- (1) If a case involves a tax-exempt entity engaging in a prohibited tax shelter transaction (listed transaction, confidential transaction, or transaction with contractual protection), the case manager should ensure the case is referred to TE/GE on Form 5666, TE/GE Referral Information Report.
- (2) To prepare a referral to TE/GE:
  - a. Complete Form 5666, TE/GE Referral Information Report, for all referrals, following instructions attached to the form. Explain in detail why you're referring the organization with the pertinent facts in Item O of Form 5666. Provide identifying information for the organization (EIN, Name) and details about why the organization is being referred and any facts/information to support the referral.
  - b. Email the form to your manager for signature.
  - c. Download relevant information from the case file and save it as a pdf.
  - d. Email the signed Form 5666 and relevant information from the case file to TE/GE Compliance, Planning and Classification at *\*Manager EO Classification*. See also IRM 25.1.9.4, Fraud Handbook, TE/GE Fraud Development Procedures. TE/GE entities include charities, donor advised funds, social welfare organizations, labor unions, golf and swim clubs, retirement funds, Indian tribes, tax exempt bonds, and state and local governments. TE/GE entities may engage in prohibited tax shelter transactions to offset unrelated business taxable income, or to accommodate taxpayers seeking to shelter income with a deduction for a charitable contribution or other expense, or diversion of taxable income into an exempt entity.

4.46.4.7  
(12-13-2018)  
**Information Document  
Request Process**

- (1) The Information Document Request (IDR) Process will be used for all LB&I examinations. The IDR Process is a structured process used when gathering information during an examination. It is intended to encourage collaboration between the taxpayer and the IRS to discuss and determine the necessary information for proper issue development.
- (2) General procedures and enforcement procedures are part of the IDR Process found in Exhibit 4.46.4-1 and Exhibit 4.46.4-2.

4.46.4.7.1  
(09-23-2021)  
**General IDR Procedures**

- (1) A paper or electronic Form 4564, Information Document Request (IDR), should be used to request information from the taxpayer. Three copies of the form should be prepared and distributed as follows:
  - a. The original will be given to the taxpayer.
  - b. A copy of the IDR (paper or electronic) will be filed in the IDR Log (if a paper log is maintained). The team coordinator is responsible for maintaining the IDR Log. Appropriate information should be listed in the log as IDRs are issued. The case manager is responsible for ensuring that the IDR Log is properly, accurately and timely completed. IMS is used to track IDR status and enforcement.
  - c. A copy of the IDR (paper or electronic) will be maintained by the issuing examiner with the issue workpapers. IMS is also used for this purpose.
- (2) IDRs are an important part of the information gathering process during any examination. When issuing IDRs, LB&I examiners must follow the requirements for issuing IDRs that are described in Exhibit 4.46.4-1, Requirements for Issuing IDRs.

- (3) If a taxpayer indicates that any requested information will not be provided without a summons, then the IRS should move directly to issue a summons.
- (4) If a taxpayer responds to an IDR with documents marked as “FRE 408” or “For Settlement Purposes Only,” or variations thereof, see IRM 4.46.5.3, Resolution vs. Settlement. Further, the IRS should request (preferably in writing) that the taxpayer re-submit the documents without any such markings.
- (5) If a taxpayer fails to submit documentation in response to an IDR and that documentation is located outside the United States, the Cross Border Activities (CBA) Information Gathering Practice Network team can provide information with respect to the applicability of a formal document request under IRC 982.

4.46.4.7.2  
(12-13-2018)

**The Initial Transfer  
Pricing Documentation  
IDR**

- (1) See IRM 4.61.3.4.3.1, Issuing the Initial Transfer Pricing Documentation IDR for the Taxpayer’s IRC 6662(e) Documentation, for requesting the Taxpayer’s IRC 6662(e) Documentation and the Transfer Pricing Examination Process guide for further processes for IRC 482 exams. The Initial Transfer Pricing Documentation IDR is issued in the following circumstances:
  - a. For examinations arising under approved LB&I campaigns, examination team members will follow the specific guidance for the Initial Transfer Pricing Documentation IDR provided for within the campaign. If no such guidance is provided, the procedures in item b. below, will apply.
  - b. For examinations with initial indications of transfer pricing compliance risk (considering the volume and type of transactions), Transfer Pricing Practice (TPP) and/or CBA Practice Area employees will issue the Initial Transfer Pricing Documentation IDR if assigned to the case. If TPP or CBA resources are not assigned as a consultant or team member to the case, the Initial Transfer Pricing Documentation IDR will not be issued.
- (2) In all circumstances, time expended for the issuance of the Initial Transfer Pricing Documentation IDR will be charged to SAIN 003 Preliminary Exam Time; UIL 00000.00-00 – Administrative Procedures until the examination team decides the issue will be developed and then the appropriate international UIL code (i.e., 9411, 9422, 9423) should be used.

4.46.4.7.3  
(09-06-2023)

**IDR Enforcement  
Process**

- (1) IDRs must be in compliance with the general IDR procedures of IRM 4.46.4.7.1 before the IRS can issue a summons based on the IDR and later seek summons enforcement. The process for enforcing delinquent IDRs from delinquency to summons issuance has three graduated steps:

1. a Delinquency Notice
2. a Pre-Summons Letter
3. a Summons

This process is mandatory and has limited exceptions. It requires LB&I managers at all levels to be actively involved early in the process and ensures that Counsel is prepared to support IDRs through the issuance of a summons when necessary. If, during the discussion of an IDR, a taxpayer indicates that the requested information will not be provided without a summons, then the IDR enforcement procedures do not apply and the IRS should move directly to issue a summons.

- (2) The timing of the enforcement process is described in Exhibit 4.46.4-2, IDR Enforcement Process.
- (3) The mandatory IDR Enforcement procedure is not required for examinations with listed transactions, transactions of interest, or Micro Captive and Syndicated Conservation Easement cases. Instead examiners should follow the Servicewide summons procedures in IRM 25.5, Summons.

## 4.46.4.8 (12-13-2018) Issue Management and Development

- (1) The issue manager is responsible for ensuring that the issue team is held accountable for the development of their respective issue(s). In addition, the issue manager must keep the case manager informed of the progress of the issue(s) and must inform the case manager of any potential impact the issue(s) may have on the case timeline. Any conflicts between the issue manager and the case manager about the development of an issue should be elevated to senior management.

**Note:** If no issue manager is designated, the case manager is by default the issue manager.

- (2) The issue manager has primary responsibility for managing the issue(s) as described in IRM 4.46.1, LB&I Examination Process, General Information and Definitions.
- (3) In addition to the case manager responsibilities described in IRM 4.46.1, the case manager will support the issue manager in developing the issue(s).
- (4) Each issue will be risk assessed and evaluated as facts are developed. Information provided by taxpayers such as presentations, IDR responses or tax workpapers will be considered by the issue team for purposes of continuing, expanding, narrowing or dropping the issue(s).
- (5) Issue development should be monitored and documented contemporaneously. Methods to monitor include:
  - Taxpayer status meetings/discussions
  - Internal team meetings/discussions
  - On-site visits and case or issue reviews (See Exhibit 4.46.4-5)
  - Mid-cycle risk analysis
  - Conference calls/instant messaging
  - IBMIS reports
  - IMS Team website
- (6) The issue team will consult with SMEs and Counsel as needed.
- (7) To facilitate early issue resolution, NOPAs will be issued as soon as a tax determination is made or by the milestone date, whichever is sooner. NOPAs should not be held until the end of the examination.
- (8) The issue team must advise the taxpayer when a determination is made, or that no adjustment will be proposed and the issue is closed.

## 4.46.4.9 (12-13-2018) Case Monitoring and Management

- (1) The case manager and team coordinator will monitor various aspects of the examination, and solicit the issue team's participation as needed. Monitoring the progress of the examination is essential as the case manager must respond to changing circumstances.

- (2) The case manager will collaborate with issue managers on the progress and development of the issues. When changes are made that impact the ECD, the case manager will discuss changes with the issue managers and the taxpayer.
- (3) If extending an issue timeline requires extending the case timeline and the ECD, the issue manager will explain to the case manager the reason for extending the issue timeline and will also prepare a revised issue timeline with a written explanation. Once that issue manager and the case manager agree that extending the ECD is appropriate, they will follow practice area policy for requesting approval to extend the ECD and, if necessary, the statute of limitations.

4.46.4.10  
(12-13-2018)  
**Continuous Risk  
Analysis**

- (1) Examiners must use their professional judgment to determine which issues will continue to be examined or modified in scope. A change of issue team members or availability may necessitate a change in scope. New information discovered by LB&I during an examination may necessitate expanding or modifying the examination plan, including the addition of new issues to the examination plan.
- (2) When a new issue(s) is discovered during the examination, the case manager will follow LB&I policy to add new issue(s) to the examination plan.
- (3) New information provided by the taxpayer that could result in a refund will require a valid informal claim if there is nexus with an issue identified for examination; otherwise, a formal claim is required if the information is provided after the initial period to submit informal claims. Also see IRM 4.46.3.7, LB&I Claims Process.
- (4) The exam team will collaborate with the taxpayer to appropriately modify an existing timeline or establish an issue team and timeline when adding a new issue.
- (5) To ensure consistency and obtain additional technical expertise, Counsel and other technical experts should be consulted. This will enable the issue team to make the most effective and efficient decision for the government.
- (6) Materiality and compliance considerations will be evaluated when conducting the risk analysis for each issue. As soon as a determination is made, the issue team will timely inform the taxpayer whether an issue is being added, continued, expanded, narrowed, or dropped.
- (7) As new information is received, such as responses to IDRs, the issue team will risk-assess each issue on a continuous basis. The issue team will analyze the information and determine whether to continue or modify the examination procedures and issue timeline.
- (8) The issue team will keep the taxpayer informed of the status of each issue through discussions and/or scheduled meetings. These discussions should be interactive and provide the taxpayer an opportunity to submit additional supporting documentation, clarify any facts and explain their tax position. These interactive discussions should promote an efficient examination.
- (9) All parties should work together to resolve issues at the earliest appropriate point in the execution phase of the examination.

4.46.4.11

(09-23-2021)

**Written Acknowledgment  
of the Facts (AOF)**

- (1) Obtaining a written acknowledgment of facts was derived from a best practice of issuing a draft Form 886-A. This process will be used by LB&I issue teams on all potentially unagreed issues, unless an exception is met.
- (2) The purpose of issuing the pro-forma AOF IDR is to ensure the issue team has considered all the relevant facts before making a final tax determination on the issue. This may avoid subsequent delays in the examination and minimizes the possibility that a case will be returned from Appeals.
- (3) LB&I requires that all information, including all relevant facts and supporting documentation, be submitted to LB&I for consideration in the development of an issue. The taxpayer is responsible for ensuring the relevant facts have been provided to LB&I, so that the law may be applied to the full set of facts.
- (4) The issue team should collaborate with the taxpayer to develop all relevant facts before issuing a NOPA. The issue team is expected to conduct on-going interactive discussions throughout the execution phase to resolve any factual disputes and discuss tax positions on issues examined.
- (5) The acknowledgment of facts pro-forma IDR (Exhibit 4.46.4-3) will include a draft Form 886-A as an attachment. The draft Form 886-A will contain all sections as outlined in IRM 4.46.6.10, Explanation of Items: Form 886-A. This process will allow the issue team to address any additional or disputed facts identified by the taxpayer before completing the final Form 886-A and issuing a NOPA.
- (6) The taxpayer's response to the AOF IDR must be documented in the case file.
- (7) Although an AOF IDR is not required for agreed issues, a draft Form 886-A may be issued as a best practice.
- (8) The taxpayer must be informed that the case will be returned for additional development if the taxpayer provides materially new information after a case is closed to Appeals. See IRM 8.7.11.6.3, Returning a Case to LB&I.
- (9) The issue team will strive to include all relevant facts in the draft Form 886-A; however, an issue team is not limited to the information contained in the draft Form 886-A when preparing the final Form 886-A. If additional information is included when the NOPA is issued, the taxpayer still retains a right to respond to that information in a written protest.
- (10) The issue manager will review the taxpayer's response to the acknowledgment of facts to assess the strengths and weaknesses of each side's position and to determine if the issue can be resolved at the examination level. In addition, the issue manager will ensure that all additional or disputed facts identified by the taxpayer in their AOF response are considered or addressed in the final Form 886-A/NOPA.
- (11) If the taxpayer does not respond by the agreed upon date, the examination should not be delayed. The issue manager will discuss the lack of response with the taxpayer and will issue the NOPA if the taxpayer does not intend to respond.
- (12) The AOF IDR may not be appropriate for all potentially unagreed issues in certain circumstances. The following should be considered when determining not to issue an AOF IDR:

- a. The presence of fraud
- b. The likelihood that a statutory notice will be issued due to an imminent statute
- c. Extenuating circumstances such as risk of harm to the development of the issue

The issue team manager in consultation with the case manager should advise senior management of the reason(s) not to issue the AOF IDR. The decision to not issue the AOF IDR must be documented in the workpapers.

- (13) The AOF IDR may not be required for a NOPA assessing penalties. The issue manager, in consultation with the case manager, will apply the guidance discussed in this section to determine if it is appropriate to issue the AOF IDR on the assertion of penalties.

**Exception:** The AOF IDR is not required for examinations with listed transaction and transaction of interest.

4.46.4.11.1  
(09-23-2021)

#### **Hold Issue Discussions**

- (1) Discussions held early and often with the taxpayer during issue development will enable the issue team to make a timely tax determination for that issue. The issue team will conduct issue discussions, share the proposed tax determination and solicit feedback on the taxpayer's position before issuing a final NOPA. All issue team members will discuss the tax issue in an open and transparent manner. Issue discussions provide an opportunity for the issue team to:

- Ensure all relevant facts have been developed
- Explain LB&I's tax determination for that issue
- Understand the taxpayer's tax position
- Strive to reach agreement on the issue

- (2) For taxpayer's statements marked as "FRE 408" or "For Settlement Purposes Only", or variations thereof, see IRM 4.46.5.3, Resolution vs. Settlement.

4.46.4.11.2  
(12-13-2018)

#### **Draft Form 886-A Explanation of Items**

- (1) The issue team will prepare and provide to the taxpayer a draft Form 886-A containing all facts and will solicit the taxpayer's written acknowledgment of the facts on potentially unagreed issues.
- (2) A draft Form 886-A should be prepared following the format outlined in IRM 4.46.6.10. The draft should be reviewed by the issue manager prior to issuance to the taxpayer.

4.46.4.11.3  
(12-13-2018)

#### **Issue the Draft Form 886-A with a Pro-Forma AOF IDR**

- (1) Use a pro-forma AOF IDR (see Exhibit 4.46.4-3) along with the Form 886-A to solicit a written acknowledgment of the facts. The draft Form 886-A and the purpose of the AOF IDR will be discussed with the taxpayer. The discussion will also establish a reasonable time for the taxpayer to respond.
- (2) Explain to the taxpayer that the pro-forma AOF IDR will not be followed by a summons and that their response to the AOF IDR does not indicate agreement to the issue or any proposed adjustments. The purpose of the pro-forma AOF IDR is to acknowledge that all relevant facts have been identified and provide the taxpayer the opportunity to submit additional relevant facts and supporting documentation or to identify disputed facts.



- (3) The taxpayer should review the draft Form 886-A and acknowledge the relevant facts using one of the options shown on the AOF IDR.
- (4) If the response is not received by the response date, do **not** follow the IDR enforcement process. The issue manager should inquire about the reasons for the delay and determine if the taxpayer intends to respond. The taxpayer's response or lack of response to the IDR will be noted in the Form 886-A when the NOPA is issued.
- (5) Use the alpha indicator prefix AOF in IMS to identify this IDR as one that will not be subject to the IDR enforcement process.

## 4.46.4.11.4 (12-13-2018) **Incorporate the Taxpayer's Response in the Final Form 886-A Issued with the NOPA**

- (1) The issue team will ensure that all relevant facts have been incorporated and considered in the final Form 886-A. A statement indicating the taxpayer's response to the IDR must be included in the opening of the Facts section. The issue team will determine the appropriate explanation when incorporating the taxpayer's response to the AOF IDR.
- (2) In addition, an explanation of whether the issue team agrees or disagrees with the additional or disputed facts provided by the taxpayer must be included. The issue team will identify the additional or disputed facts provided by the taxpayer in a subsection of the Facts section in the final Form 886-A or, if voluminous, include the taxpayer's response as an attachment to the final Form 886-A. It is impossible to capture every scenario you may encounter; however, some examples are provided for options to use in documenting the response.
  - a. **Example 1: Taxpayer Agrees with the Facts** "The taxpayer was issued IDR AOF#\_\_\_ on January 1, 20xx to acknowledge all relevant facts have been provided. The taxpayer agreed with the facts as written."
  - b. **Example 2: Taxpayer Provided Additional Facts** "The taxpayer was issued IDR AOF# \_\_\_on January 1, 20xx to acknowledge all relevant facts have been provided. The taxpayer provided additional facts, which LB&I has taken into consideration. The tax determination was modified to reflect the additional facts provided; however, the issue remains unagreed. The additional facts provided by the taxpayer are detailed in the Facts section." OR "...are included as an attachment."
  - c. **Example 3: Taxpayer Identifies Disputed Facts** "The taxpayer was issued the IDR AOF#\_\_\_ on January 1, 20xx to acknowledge all relevant facts have been provided. The taxpayer identified disputed facts. The disputed facts have been included in a subsection at the end of the Facts section." OR "...have been included as an attachment to the Form 886-A."
  - d. **Example 4: Taxpayer Did Not Respond to the Pro-Forma IDR** "The taxpayer was provided the IDR AOF#\_\_\_ on January 1, 20xx to acknowledge all relevant facts have been provided. The taxpayer did not respond to the IDR by the agreed upon response date. A follow-up discussion between the taxpayer and the issue manager was held on January 15, 20XX. During the discussion the taxpayer stated that..."
- (3) The issue manager will ensure that all relevant facts, including additional and/or disputed facts, are appropriately considered in determining LB&I's tax position before the issue team issues the NOPA. The issue manager must approve the potentially unagreed NOPA before issuing to the taxpayer.

4.46.4.12  
(03-01-2006)

**Penalty Consideration**

- (1) The Service maintains an ongoing effort to develop, monitor and revise programs designed to assist taxpayers in complying with legal requirements and avoiding penalties. As indicated in Policy Statement P-20-1, the Service uses penalties to encourage voluntary compliance.
- (2) Policy Statement P-20-1 also states that the IRS administers a penalty policy that is designed to:
  - a. Ensure consistency.
  - b. Ensure accuracy of results in light of the facts and the law.
  - c. Provide methods for taxpayers to have their interests heard and considered.
  - d. Require impartiality and commitment to achieve the correct decisions.
  - e. Allow for prompt reversal of initial determinations when sufficient information has been presented to indicate that the penalty is not appropriate.
  - f. Ensure that penalties are used for their proper purpose and not as bargaining points in the development or processing of cases.

4.46.4.12.1  
(09-06-2023)

**Examiner Responsibility**

- (1) The examiner is responsible for identifying the appropriate penalties, determining whether to assert penalties, developing the penalty issue and accurately calculating the penalty amount.
- (2) The examiner asserting the penalty will inform the taxpayer as early as possible when and why penalties are being considered. The examiner will provide the taxpayer an opportunity to respond to the assertion based on facts and law. Examiners asserting a penalty must ensure the penalty lead sheet (currently SAIN 011) is signed by their immediate supervisor or case manager (see IRM 4.46.4.12.2) to document approval of penalties **prior** to issuing any written communication of penalties to a taxpayer that offers the taxpayer an opportunity to: sign an agreement, or consent to assessment or proposal of the penalty. See IRM 20.1.1.2.3.1, Timing of Supervisory Approval.
- (3) Examiners must document the reasons for imposing or not imposing penalties and the manager's involvement on Form 9984, Examining Officer's Activity Record, or in the workpapers related to the penalty under consideration. See IRM 20.1.1.2.3, Approval Prerequisite to Penalty Assessment, for additional guidance.
- (4) Consult with Counsel or a penalty subject matter expert, if needed.
- (5) The pro-forma AOF IDR may not be required for a a penalty issue. See IRM 4.46.4.11 for additional guidance.

4.46.4.12.2  
(09-06-2023)

**Managerial Involvement**

- (1) The case manager and issue manager should be actively involved with the development of all penalty issues. Coordination with Criminal Investigation and penalty SMEs may be required.
- (2) The immediate supervisor of the employee asserting the penalty or the case manager (see paragraph (3) below) must approve:
  - Any penalty asserted prior to issuing any written communication of penalties to a taxpayer that offers the taxpayer an opportunity to sign an agreement or consent to assessment or proposal of the penalty
  - Any case where there is a substantial understatement of tax and no penalty proposed



- Non-assertion of IRC 6676 penalty when a substantial portion of the claim for refund or credit is disallowed (see IRM 20.1.5.18.5(14), Case Procedures WITHOUT Deficiency Procedures)

**Exception:** Exceptions to the supervisory approval of penalties are noted in IRM 20.1.5.2.3, Supervisory Approval of Penalties - IRC 6751 Procedural Requirements and IRC 6751(b)(2).

- (3) The case manager is designated as a higher-level official to approve an initial determination of a penalty assessment even where initial determination was made by someone not in the same operating division, group, or management chain of the person who made the initial determination so long as the penalty arises from an examination to which the case manager is assigned. Also, a person serving in an acting capacity may exercise the authority of the position in which the person is acting to approve initial penalty determinations. See IRM 1.11.4.5, Purpose and Contents of Delegation Orders. The initial determination of the penalty must be personally approved in writing; any writing, including in electronic form, made by the writer to signify the writer's assent. No signature or particular words are required so long as the circumstances of the writing reflect that it was intended as approval. For example, the case manager's approval **may be in the form of a signature on Form 5701, the Examination Report, Revenue Agent Report (RAR) or a 30-day letter.**
- (4) The following are some examples that illustrate the designation of a higher-level official.

Example 1: The immediate supervisor (the issue manager) of the individual who made the initial penalty determination is not available to approve the penalty. The case manager may approve the initial determination of the penalty as a higher-level official.

Example 2: In the course of an audit of Taxpayer T by a team of revenue agents, Revenue Agent A concludes that T should be subject to an accuracy-related penalty for negligence under IRC 6662(b)(1) and IRC 6662(c). Supervisor B is the issue manager and is assigned the duty to approve the Notice of Proposed Adjustment for any penalty A would propose. A reports to B, but B is not responsible for the overall management of the audit of T. C is the case manager of the team auditing T and is responsible for the overall management of the audit of T. C may assign tasks to A and other team members, and has responsibility for approving any examination report presented to T. The requirements of IRC 6751(b)(1) are met in either of the following instances:

- Only B approves the penalty in writing before the mailing to T of a 30-day letter that includes the penalty. B qualifies as the immediate supervisor of A with respect to A's penalty proposal.
  - Only C approves the penalty in writing before the mailing to T of a 30-day letter that includes the penalty. Because C is the case manager of the team auditing T, and A is a team member, C qualifies as a higher-level official designated to approve the penalty proposed by A.
- (5) The LB&I Issue Management System (IMS) provides lead sheets based on the standard audit index number (SAIN) entry for the penalty issue. The penalty lead sheet (currently SAIN 011) may be used to approve penalties in LB&I. IMS forms may be approved with a digital or physical signature.

- (6) For more information see IRM 20.1.1.2.3 Approval Prerequisite to Penalty Assessments.

4.46.4.12.3  
(12-13-2018)

#### **Common Penalties**

- (1) See IRM 20.1, Penalty Handbook, for a list of common civil tax penalties. This list includes the applicable IRC section, penalty amount and description, penalty reference numbers, detailed explanation and computation methods. These penalties include, but are not limited to the following:
- a. Failure to pay estimated income tax
  - b. Failure to file
  - c. Failure to pay
  - d. Fraud
  - e. Frivolous returns
  - f. Accuracy-related penalties on underpayment, including negligence or disregard of rules or regulations, substantial understatement of income tax, substantial or gross valuation misstatements
  - g. Accuracy-related penalties on understatements with respect to a reportable transaction
  - h. Failure to include reportable transaction information with a return
  - i. Erroneous claim for refund or credit

4.46.4.12.4  
(09-23-2021)

#### **Penalties Relating to International Issues**

- (1) There are very specific penalties relating to international issues. Identifying the appropriate penalties relating to international issues is covered in IRM 20.1.9, International Penalties. For additional assistance, contact the Information Gathering Practice Network team on the virtual library at <https://irs.gov.sharepoint.com/sites/ETD-KMT-KB008>.

4.46.4.12.5  
(12-13-2018)

#### **Fraud**

- (1) A civil fraud penalty case may be developed based on the facts and circumstances of a civil examination or may occur at the completion of a criminal prosecution case. In either situation, the examiner and team manager must contact their local Fraud Enforcement Advisor (FEA) when fraud is suspected. The examiner and FEA will jointly prepare Form 11661, Fraud Development Recommendation – Examination.
- (2) Assertion of a civil penalty is a shared responsibility of the examiner, team manager and FEA. Civil fraud determinations no longer require a referral or concurrence by Criminal Investigation. The procedures described in IRM 25.1.6, Civil Fraud, relative to civil fraud cases must be followed.
- (3) If during the fraud development process, firm indications of fraud exist and criminal criteria is met, a referral via Form 2797, Referral Report of Potential Criminal Fraud, must be prepared and submitted via the Fraud Enforcement Advisor to Criminal Investigation.
- (4) Specific guidance on all aspects of both criminal and civil fraud are described in IRM 25.1, Fraud Handbook. IRM 25.1.10, LB&I Fraud Procedures, addresses additional procedures required for LB&I cases.
- (5) The pro-forma AOF IDR may not be appropriate in fraud cases. Extenuating facts and circumstances should be considered in determining whether to issue the AOF IDR. See IRM 4.46.4.11 for additional guidance.

4.46.4.12.6  
(09-06-2023)  
**Workpaper  
Documentation on  
Penalties**

- (1) The consideration, assertion or non-assertion, and computation of all applicable penalties must be documented in the case file. An applicable penalty is defined to be one which the legal premise for application is present in the case. The decision to assert penalties must have a legal basis in the Internal Revenue Code or other authority.
- (2) Penalties will not be asserted without an explanation and without written supervisory approval. See IRM 4.46.4.12.1 and IRM 20.1.1.2.3, Approval Prerequisite to Penalty Assertion. The extent of the explanation will depend upon the nature of the adjustments and the amounts involved. However, “canned” statements, such as “negligence penalty applicable” or “negligence penalty deemed to be not applicable,” are not sufficient. Supervisory approval of penalties must be personally documented in writing by the immediate supervisor of the individual making the initial determination to assess a penalty, or such higher-level official as the Secretary may designate. The case manager is designated as such higher-level official. Refer to IRM 4.46.4.12.2.
- (3) Alternative penalty positions should be documented in the workpapers when applicable (e.g., fraud versus negligence penalties and various components of the accuracy-related penalty). Written supervisory approval must be obtained for each alternative penalty position taken.

4.46.4.12.7  
(12-13-2018)  
**Burden of Proof  
Regarding Assessment  
of Penalties**

- (1) IRC 7491(c), which applies only to individuals, states that the IRS has the burden of production in a court proceeding when the issue is a penalty, an addition to tax, or an additional amount imposed by the Internal Revenue Code. The IRS must first present evidence that imposition of the amount is appropriate. Only then does the taxpayer assume the burden of persuasion to raise appropriate defenses, such as reasonable cause, to the imposition of the penalty, addition to tax, or additional amount imposed by the Code. Also see IRM 25.1.6, Civil Fraud.

4.46.4.12.8  
(03-01-2006)  
**Definitions**

- (1) The following definitions are related to the burden of proof requirements for assessment of penalties:
  - a. **Penalties** include all penalties assessed under Title 26 and/or 31. An example is IRC 6662 that imposes the accuracy-related penalty on underpayments.
  - b. **Addition to Tax** is any amount computed by reference to the amount of tax. An example is the addition to tax imposed by IRC 6654 for failure by an individual to pay estimated income tax.
  - c. **Additional Amount** refers to an amount that can be assessed by the IRS that is not an addition to tax or penalty. An example is the amount imposed under IRC 6673 for sanctions and costs awarded by a court when a taxpayer’s position is frivolous. Additional amounts under IRC 7491(c) do not include excise taxes imposed by chapters 42 and 43 of the Internal Revenue Code or interest under IRC 6601.

4.46.4.12.9  
(09-06-2023)  
**Economic Substance  
Doctrine**

- (1) On March 30, 2010, the Health Care and Education Reconciliation Act of 2010 was enacted. This law amended the Internal Revenue Code to codify the Economic Substance Doctrine under IRC 7701(o). It also amended penalty provisions under IRC 6662, IRC 6662A, IRC 6664 and IRC 6676.
- (2) IRC 6662 was amended to add a new penalty to be applied to any underpayment attributable to transactions lacking economic substance. The penalty

under IRC 6662(b)(6) applies a 20 percent penalty on noneconomic substance transactions. IRC 6662(i) increases the penalty to 40 percent if the relevant facts affecting the tax treatment are not adequately disclosed. The penalty is applicable for transactions entered into after March 30, 2010.

- (3) See Exhibit 4.46.4-4 for guidance on the economic substance doctrine and related penalties.
- (4) See Notice 2014-58 for additional guidance regarding penalties associated with the Economic Substance Doctrine.

**4.46.4.13**  
(12-13-2018)  
**Notice of Proposed  
Adjustment (NOPA)**

- (1) For LB&I cases, all adjustments are proposed on Form 5701, Notice of Proposed Adjustment, which is generally accompanied by Form 886-A, Explanation of Items. Form 5701 provides a summary of the proposed adjustment. Form 886-A provides a detailed explanation of the adjustment.
- (2) When issuing a NOPA, the tax determination for that issue is based on applying the law to the relevant facts developed during the examination. NOPAs will be issued as soon as a tax determination has been made but no later than the milestone date set in the issue timeline.
- (3) For those examined issues, which are known to be agreed through discussions with the taxpayer, it is still important to develop an effective Form 886-A to provide an understanding of the audit trail. An effective Form 886-A will also assist future audits to understand what was examined and the law applied to reach the conclusions. See IRM 4.46.6.10, Explanation of Items: Form 886-A.
- (4) For issues identified through affirmatives, informal or formal claims that are accepted without examination, the team coordinator should incorporate the accepted issues into the revenue agents report. If appropriate, the accepted issues may be grouped together on one Form 5701. See IRM 4.46.3.7.4, Grouping of Claims and Affirmative Issue(s). If the explanation of the adjustment is longer than the space provided on the Form 5701, then one brief Form 886-A can be used to explain each accepted affirmative and claim issue.
- (5) The issue manager will review the Form 886-A and Form 5701 for accuracy and completeness before signing the Form 5701. In certain circumstances, senior manager approval may be warranted.
- (6) For issues that are potentially unagreed, the issue team must solicit an acknowledgment of the facts (see IRM 4.46.4.11) before issuing a NOPA. The issue manager should review the Form 886-A to ensure that the taxpayer's additional and/or disputed facts are included and appropriately considered. The issue manager should also assess the strengths and weaknesses of both side's position and determine if the issue can be resolved at the examination level.

**4.46.4.13.1**  
(12-13-2018)  
**NOPA Response Date**

- (1) During the planning phase, the examination team and the taxpayer should agree to a reasonable timeframe for responses to NOPAs unless a standard response date for all NOPAs is determined at the opening conference. Refer to Opening Conference Agenda, IRM Exhibit 4.46.3-3, Sample Agenda for Opening Conference Meeting.

- (2) To facilitate early issue resolution, the NOPA will be presented to the taxpayer as soon as the issue team reaches a tax determination for that issue, instead of at the end of the examination.
- (3) Before issuing a NOPA, the issue team must discuss and should agree to a reasonable date for the taxpayer's response, unless a standard response date for all NOPAs was established at the opening conference.
- (4) If the taxpayer does not agree to a proposed response date, then a date will be set by the issue manager.

## 4.46.4.13.2 (12-13-2018) **Issue the NOPA**

- (1) The issue manager has the responsibility to review each NOPA for accuracy, organization and completeness, and approve by signing the Form 5701 before issuing the NOPA to the taxpayer. NOPAs meeting certain dollar thresholds or on specific issues may require senior manager approval.
- (2) The issue team must discuss the issues with the taxpayer before issuing a NOPA. Items to be discussed before issuing the NOPA are:
  - a. The government's position and an explanation of the law applied in making each determination
  - b. The taxpayer's anticipated response date to the NOPA
- (3) In addition, for unagreed issues:
  - a. Fast Track settlement must be considered, if appropriate. Other issue resolution tools should be considered, as warranted.
  - b. Remind the taxpayer that if a case is closed to Appeals and new information is provided by the taxpayer, the case will be returned to LB&I's jurisdiction for consideration. If the taxpayer raises a new theory or alternate legal argument, the case will remain in Appeals' jurisdiction, but the examination team will be given the opportunity to respond in writing to the new argument. See IRM 8.7.11.6.3, Returning a Case to LB&I.
  - c. The issue team should remind the taxpayer to provide a legal position by the NOPA response date.

## 4.46.4.13.3 (12-13-2018) **Taxpayer's Written Response to Unagreed Issues**

- (1) The taxpayer will be requested to provide a written response to the NOPA within an agreed upon date. The taxpayer's response, which should describe in detail the legal position on which the taxpayer relies, will allow the issue team to more quickly determine the appropriate resolution tool such as Fast Track or Early Referral to Appeals. The sooner each issue is resolved, the sooner resources of both the taxpayer and LB&I can be applied elsewhere.
- (2) If the response is not received by the agreed response date, the issue manager should inquire about the reasons for the delay and if the taxpayer intends to respond.

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**Exhibit 4.46.4-1 (12-13-2018)**  
**Requirements for Issuing IDRs**

IDRs are an important part of the information gathering process during any examination. When issuing IDRs, LB&I examiners and specialists should follow the requirements listed below:

1. Discuss the issue related to the IDR with the taxpayer.
2. Discuss how the information requested is related to the issue under consideration and why it is necessary.
3. After this consultation with the taxpayer, determine what information will ultimately be requested in the IDR.
4. Ensure the IDR clearly states the issue that is being considered and that the IDR only requests information relevant to the stated issue. An IDR issued at the beginning of an examination that requests basic books and records and general information about a taxpayer's business is not subject to this requirement. Once this initial IDR has been issued, subsequent IDRs must state an issue to be in compliance with this requirement.
5. Only one issue should be addressed on each IDR.
6. Utilize numbers or letters on the IDR for clarity.
7. Ensure that the IDR is written using clear and concise language.
8. Ensure that the IDR is customized to the taxpayer or industry.
9. Provide a draft of the IDR and discuss its contents with the taxpayer. Generally, this process should be completed within 10 business days.
10. After this discussion is complete, determine a reasonable timeframe for a response to the IDR.
11. If agreement on a response date cannot be reached, the examiner or specialist will set a reasonable response date for the IDR.
12. When determining the response date, ensure that the examiner or specialist commits to a date by which the IDR response will be reviewed and a response provided to the taxpayer on whether the information received satisfies the IDR. Note this date on the IDR issued to the taxpayer.



**Exhibit 4.46.4-2 (09-23-2021)**  
**IDR Enforcement Process**

IDRs that are issued in compliance with the requirements of Exhibit 4.46.4-1 are subject to the enforcement process set forth in this Exhibit 4.46.4-2.

The process has three graduated steps:

1. a Delinquency Notice
2. a Pre-Summons Letter
3. a Summons

This process is mandatory with limited exceptions. The timing of the application of the enforcement process is set forth below in a separate section. The IDR Enforcement Process is not required for examinations with listed transactions and transactions of interest. Instead examiners should follow the Servicewide summons procedures detailed in IRM 25.5 , Summons.

**Extension Authority**

Before the Enforcement Process is triggered, an examiner or specialist has the authority to grant a taxpayer an extension of up to 15 business days before the Enforcement Process begins. An examiner or specialist may grant one extension with respect to the same IDR. This extension may be granted in the following two situations:

1. **Taxpayer Fails to Respond.** If a taxpayer fails to provide any response by the IDR due date, the examiner or specialist will, within 5 business days after the IDR due date, discuss with the taxpayer the cause of the failure to respond and determine if an extension is warranted. If the examiner or specialist determines that the taxpayer's explanation warrants more time, then the examiner or specialist may grant the taxpayer an extension of up to 15 business days from the date the extension determination is made and communicated to the taxpayer.
2. **Taxpayer Provides Incomplete Response** If a response is received but the examiner or specialist determines that it is not complete, the examiner or specialist should discuss with the taxpayer the reasons why the response is not complete and determine within 5 business days whether an extension is warranted. If the examiner or specialist determines that the taxpayer's explanation warrants more time, then the examiner or specialist may grant the taxpayer an extension of up to 15 business days from the time the extension determination is communicated to the taxpayers.

**Timing of Application of IDR Enforcement Process**

The timing of the application of the IDR Enforcement Process is set forth below.

**No Response Received by Due Date**

1. If no response is received by the IDR due date and no extension is granted, the IDR enforcement process begins on the date the determination not to extend is communicated to the taxpayer.
2. If an extension is granted and no response is received by the extended due date, the IDR enforcement process begins as of the extended due date.

**Response Received by Due Date**

If a response is received by the due date, the IRS must determine whether the response is complete. This determination should be made on or before the date the examiner or specialist stated in the IDR.

1. **If the IDR is considered complete upon review**, the examiner or specialist must notify the taxpayer that the IDR is complete and closed.
2. If the IDR response is not complete, the timing of the enforcement process is as follows:



## Exhibit 4.46.4-2 (Cont. 1) (09-23-2021)

### IDR Enforcement Process

- a. **If the IDR response is not complete and no extension is granted**, the IDR enforcement process begins on the date the determination not to extend is communicated to the taxpayer.
- b. **If the IDR response is not complete and an extension is granted:**
  - a. If no additional information is received at the end of the extension period (may be up to 15 business days), the IDR enforcement process begins as of the extended due date.
  - b. If additional information is received at the end of the extension period, this information must be reviewed for completeness. This review should be completed as soon as practical but in most cases not more than 15 business days from receipt of the response. If the IDR response is determined to be incomplete, the IDR enforcement process begins on the date the examiner or specialist notifies the taxpayer that the response remains incomplete. If the IDR is complete, the examiner or specialist should notify the taxpayer and close the IDR.

### Delinquency Notice (Letter 5077)

Once the IDR Enforcement Process applies based on the timing described in the above section titled “Timing of Application of IDR Enforcement Process,” the examiner or specialist along with their manager must complete the first phase of the enforcement process, the delinquency notice, by following the procedures described below:

1. Discuss the delinquency notice with the taxpayer. During this discussion, ensure that the taxpayer understands the next steps in the enforcement process if the information requested in the IDR is not provided by the response date established in the delinquency notice.
2. Issue the delinquency notice signed by the team manager to the taxpayer within 10 days of beginning the enforcement process.
3. The delinquency notice should include a response date that is generally no more than 10 business days from the date of the delinquency notice. A territory manager must approve any date beyond 10 business days.
4. Provide a copy of the delinquency notice and the IDR to assigned Counsel.

### Pre-Summons Letter (Letter 5078)

If a taxpayer does not provide a complete response to an IDR by the delinquency notice response date, the examiner or specialist must complete the next phase of the enforcement process, the pre-summons letter, by following the procedures described below:

1. Discuss the lack of a complete response to the delinquency notice with the team manager, specialist manager, the respective territory managers and Counsel and prepare the pre-summons letter.
2. The appropriate territory manager must discuss the pre-summons letter with the taxpayer. During this discussion, ensure that the taxpayer understands the next steps in the enforcement process if the information requested in the IDR is not provided by the response date established in the pre-summons letter.
3. Issue a pre-summons letter to the taxpayer signed by the appropriate territory manager. This must be done as quickly as possible but generally no later than 10 business days after the due date of the delinquency notice. Address this letter to the taxpayer management official that is at a level equivalent to the LB&I territory manager. This should be a level of management above the taxpayer management official that received the delinquency notice.
4. Include a response date in the pre-summons letter that is generally 10 business days from date of the pre-summons letter.
5. A Director of Field Operations (DFO) must approve any date beyond the 10 business day response period.
6. Discuss the pre-summons letter with Counsel.

**Exhibit 4.46.4-2 (Cont. 2) (09-23-2021)**  
**IDR Enforcement Process**

7. DFO(s) must be made aware of the pre-summons letter prior to issuance.

**Summons**

If a taxpayer does not provide a complete response to an IDR by the pre-summons letter response date, the examiner or specialist must complete the next phase of the enforcement process, the summons, by following the procedures described below:

1. Discuss the lack of response to the pre-summons letter with the case manager, issue manager, the respective territory managers and DFOs, and Counsel.
2. Solicit Counsel's assistance in the preparation of the summons to ensure the summons is enforceable
3. Coordinate the issuance of the summons with assigned Counsel. It is imperative that the summons procedures are strictly followed. If the procedures are not followed, the summons will not be enforceable.
4. Summons procedures can be found in IRM 25.5.

## Exhibit 4.46.4-3 (12-13-2018)

### Pro-Forma IDR for Acknowledgment of Facts on Unagreed Issues

Form <b>4564</b> (Rev. September 2006)	Department of the Treasury — Internal Revenue Service <b>Information Document Request</b>	Request Number
To: (Name of Taxpayer and Company Division or Branch)		Subject
		SAIN number      Submitted to:
		Dates of Previous Requests (mmddyyyy)

Please return Part 2 with listed documents to requester identified below

#### Description of documents requested

The purpose of this Acknowledgment of Facts (AOF) Information Document Request (IDR) is to ensure that all relevant facts necessary to arrive at an accurate tax determination have been identified and considered before the Form 5701, Notice of Proposed Adjustment, is issued. Responding to this IDR presents the taxpayer an opportunity to provide additional relevant facts and may lead to the resolution of the issue at the examination level.

Another potential benefit of a thorough response to this IDR is preventing a delay in your case should it be returned from Appeals. The presentation of new facts in Appeals generally will require that the case be returned to Examination. Therefore, it is beneficial to ensure that all relevant facts are provided to the LB&I issue team before the Form 5701 is issued. Taxpayers are not prevented from providing additional facts in their written protest or in Appeals, but the expectation is that all relevant facts will be presented during the audit so that LB&I can make an accurate tax determination. While the interpretation of the law or the amount of the proposed adjustment may be unagreed, all relevant facts should be included in the attached draft Form 886-A.

#### Requested Items

Your response to the facts does not indicate agreement to the issue or any proposed tax adjustment.

1) Please review the attached draft Form 886-A and respond accordingly in writing to the LB&I issue team by the response date. Also, limit your response to reviewing relevant facts, advising if relevant facts are excluded, and not providing stylistic or editorial changes.

2) Please check the box(es) that apply:

- (a) ☐ The taxpayer agrees that all relevant facts are documented in the attached draft Form 886-A.
- (b) ☐ The taxpayer does not agree with specific facts documented in the draft Form 886-A. The taxpayer will identify the specific facts that are in dispute, and will provide documents to support those specific facts by the response date of this IDR that will permit the issue team to make an accurate tax determination.
- (c) ☐ The taxpayer does not agree that all relevant facts are documented in the draft Form 886-A. The taxpayer will identify all omitted relevant facts, will provide the documents upon which the taxpayer relied to support those additional facts that will permit the issue team to make an accurate tax determination, and will provide the additional facts by the response date of this IDR.
- (d) ☐ Other, please explain.

#### Additional Information

The issue manager has the responsibility to ensure that any additional or disputed facts are appropriately considered and will ensure the response is reviewed timely. Any specific concerns raised will be discussed before a final Form 886-A, Explanation of Items, is prepared.

This AOF IDR is not subject to the IDR enforcement process; however, the response or lack of response to the IDR will be referenced as part of the final Form 886-A when the Form 5701, Notice of Proposed Adjustment, is issued. It is the taxpayer's responsibility to ensure all relevant facts have been identified and presented to support the tax position taken on their return. For additional guidance see IRM 4.46.4.10 and IRM 8.6.1.7.5, Taxpayer Provides New Information.

Information Due By _____ At Next Appointment <input type="checkbox"/> Mail in <input type="checkbox"/>	
<b>From:</b>	Name and Title of Requester
	Name, Title
	Office Location
	Street Address City, State Zip code e-Fax ###-###-####
Employee ID number	Date (mmddyyyy)
Badge #####	MM/DD/YYYY
Telephone Number	
(### ) ###-####	

Catalog Number 23145K

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Part 1 - Taxpayer's File Copy

Form **4564** (Rev. 9-2006)

**Exhibit 4.46.4-4 (09-06-2023)****Guidance for Examiners and Managers on the Codified Economic Substance Doctrine and Related Penalties**

**Background:** IRC 7701(o) defines the economic substance doctrine as the common law doctrine under which certain tax benefits are not allowable if the transaction does not have economic substance or lacks a business purpose and states that “[t]he determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if [the legislation] had never been enacted.”

IRC 7701(o) resolves the long-standing conflict among various circuit courts of appeal regarding how the doctrine should be applied by codifying a two-part conjunctive test. The statute states that “in the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if—

- a. the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer’s economic position, and
- b. the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.”

IRC 6662(b)(6) imposes a strict liability penalty of 20 percent (40 percent for non disclosed transactions under IRC 6662(i) ) of any underpayment attributable to the disallowance of claimed tax benefits by reason of the application of the economic substance doctrine or failing to meet the requirements of any similar rule of law. Amendments to section 6664 make clear that the “reasonable cause” exception is not applicable to this penalty, and a corresponding amendment to section 6676 provides that a strict liability penalty also applies to refund claims, although in that case the penalty is limited to 20 percent. Even though the 20 and 40 percent penalties are strict liability penalties, such penalties must be timely approved in writing by the immediate supervisor of the person who initially determines the penalty, or the case manager (refer to IRM 4.46.4.12.2), in order to comply with IRC 6751(b). See IRM 20.1.1.2.3, Approval Prerequisite to Penalty assessments; IRM 20.1.1.2.3.1, Timing of Supervisory Approval, IRM 20.1.7.3.1 and IRM 20.1.10.2, Supervisory Approval for Penalty Assessment; IRM 20.1.5.2.3, Supervisory Approval of Penalties - IRC 6751 Procedural Requirements; IRM 20.1.5.2.3.1, Documenting Supervisory Approval of Penalties; IRM 4.46.4.12, Penalty Consideration; IRM 4.46.4, LB&I Examination Process, Executing the Examination.

IRC 7701(o) and the related strict liability accuracy-related penalty apply to transactions entered into after March 30, 2010. Examiners should follow all existing examination procedures regarding issue identification, development, resolution and related documentation requirements.

**PURPOSE OF GUIDANCE**

The purpose of this guidance is to instruct examiners and their managers how to determine when it is appropriate to raise the economic substance doctrine, (the codified economic substance doctrine under IRC 7701(o) or the common law economic substance doctrine) and related penalties. Before applying the codified economic substance doctrine or the common law economic substance doctrine to a transaction, Exam should consider all substantive arguments and technical analysis that are reasonably relevant to the proper tax treatment of the transaction. If after such consideration an examiner and their manager believe that the application of the codified economic substance doctrine or the common law economic substance doctrine may be appropriate, the examiner must consult with local field Counsel before proceeding if the issue/case is novel and/or significant or the issue has required or will require significant resources to address.

**Note:** Novel or significant issues include, but are not limited to, issues of importance to tax administration, such as case of first impression; one affecting large numbers of taxpayers or an industry; or one falling within an operating division’s major strategic goal.

## Exhibit 4.46.4-4 (Cont. 1) (09-06-2023)

### Guidance for Examiners and Managers on the Codified Economic Substance Doctrine and Related Penalties

**Reminder:** In SB/SE, when local Area Counsel contact has not been designated or a formal advice memorandum is required, examiners must send a written request for advice through the Appeals/Counsel liaison in Technical Services (see IRM 4.2.3.3.1, Assistance Available from Area Counsel, and IRM 4.8.8.12.1.2, Advice from Area Counsel).

Local field Counsel will coordinate, as required by the Chief Counsel Directives Manual (CCDM) or other applicable Chief Counsel Directive, with Division Counsel and the appropriate Associate Chief Counsel Office(s) to analyze whether assertion of the doctrine is warranted. After considering the facts received from Exam, local field Counsel will provide the examiner and their manager with Counsel's legal advice analyzing the transaction and advising the examiner on asserting the doctrine. After receiving and considering Counsel's advice, Exam will decide whether to apply the economic substance doctrine. Local field Counsel will continue to provide assistance and advice, as needed.

**Exception:** If the issue/transaction involves a Compliance Initiative Project (CIP), Campaign, or other coordinated project, the examiner should contact the CIP analyst or the Campaign or coordinated project lead with any questions about whether to apply the economic substance doctrine. If necessary, the analyst/lead will coordinate with Counsel to request a review of the facts and circumstances of the CIP/Campaign/Project issue to determine if the assertion of the doctrine is warranted. Once a decision is made, the analyst/lead will communicate that decision to examiners. On any other case, if the facts and circumstances are the same, examiners, managers, and local Counsel attorneys do not need to coordinate with or within Counsel on the assertion of the doctrine due to Counsel's previously provided advice.

### APPLICATION OF THE ECONOMIC SUBSTANCE DOCTRINE

To determine whether raising the doctrine may be appropriate, the examiner should consider all of the following and seek advice from local field Counsel on application of the doctrine to the transaction in the examination.

The following facts and circumstances tend to show that application of the economic substance doctrine may be appropriate:

- Transaction is highly structured
- Transaction includes unnecessary steps
- Transaction is not at arm's length with unrelated third parties
- Transaction creates no meaningful economic change on a present value basis (pre-tax)
- Taxpayer's potential for gain or loss is artificially limited
- Transaction accelerates a loss or duplicates a deduction
- Transaction generates a deduction that is not matched by an equivalent economic loss or expense (including artificial creation or increase in basis of an asset)
- Taxpayer holds offsetting positions that largely reduce or eliminate the economic risk of the transaction
- Transaction involves a tax-indifferent counterparty that recognizes substantial income
- Transaction results in separation of income recognition from a related deduction either between different taxpayers or between the same taxpayer in different tax years
- Transaction has no credible business purpose apart from federal tax benefits
- Transaction has no meaningful potential for profit apart from tax benefits
- Transaction has no significant risk of loss
- Tax benefit is artificially generated by the transaction
- Transaction is pre-packaged
- Transaction is outside the taxpayer's ordinary business operations

**Exhibit 4.46.4-4 (Cont. 2) (09-06-2023)****Guidance for Examiners and Managers on the Codified Economic Substance Doctrine and Related Penalties**

The list above is not all inclusive. Examiners, their managers, and Counsel consider all the relevant facts and circumstances of the case in determining the best and most appropriate legal arguments to make; whether it's the primary or alternative position of the government. The absence of something from this list does not limit an examiner's ability to consider whether to apply the Economic Substance Doctrine (ESD). And the ESD can be applied in addition to other judicial doctrines.

Consistent with the treatment of other issues, notification to the taxpayer of an ESD related issue/argument in LB&I cases is governed by the existing LB&I Examination Process (LEP)/Pub 5125 and IRM 4.46 rules.

Notwithstanding existence of the above facts and circumstances, the economic substance doctrine may not be appropriate if the transaction that generates targeted tax incentives is, in form and substance, consistent with Congressional intent in providing the incentives.

**CONSIDERATION OF OTHER JUDICIAL DOCTRINES**

The economic substance doctrine may be applied in addition to other judicial doctrines (e.g., substance over form or step transaction) either as a primary argument or as an alternative position to those judicial doctrines depending on the facts and circumstances of the case. Likewise, if recharacterizing a transaction (e.g., recharacterizing debt as equity, recharacterizing someone as an agent of another, recharacterizing a partnership interest as another kind of interest, or recharacterizing a collection of financial products as another kind of interest) addresses the noncompliance that is being examined, then recharacterization should be applied and the economic substance doctrine may be considered as either a primary or alternative position based on the facts and circumstances of the case.

This guidance is not an official pronouncement of law, and cannot be used, cited or relied upon as such.

**Exhibit 4.46.4-5 (12-13-2018)****On-Site Visits and Case or Issue Reviews**

On-site visits and case or issue reviews by the case and/or issue manager can be an effective method to monitor the progress of the case and/or development of tax issues. Before a review is conducted, the manager should prepare an agenda to ensure the time spent is focused and productive. When the on-site visit includes a meeting with the taxpayer, the agenda should be shared with the examination team and provided to the taxpayer in advance to allow sufficient time for the taxpayer to add items to the agenda, and conduct any research, inquiry, or development of background material necessary for meaningful discussions.

**On-Site Activities and Case or Issue Reviews**

In addition to the items mentioned in IRM 4.46.4.8, Issue Management and Development, and IRM 4.46.4.9, Case Monitoring and Management, the case or issue manager during on-site visits should ensure that:

- Issue discussions are being conducted in a transparent and cooperative manner during the development of each issue.
- The IDR management and enforcement process are being followed.
- Continuous risk analysis is being conducted for each issue.
- Issue teams have the appropriate resources needed to develop an issue.
- The LEP claims process is being followed.
- Issue teams are conducting interactive discussions to resolve any factual or legal differences.
- The law is being applied to the facts with an unbiased view.
- LB&I issue team members take a unified approach on a tax position when discussing with the taxpayer.
- LB&I and the taxpayer understand each side's tax positions.
- The acknowledgment of the facts IDR for unagreed issues has been issued and discussed with the taxpayer.
- Forms 4764-B and related workpapers are being completed contemporaneously and reviewed.
- Action items from previous on-site visits or reviews have been addressed.

The case manager and issue manager should keep each other informed of the outcome of these visits or reviews.

**Documenting On-Site Visits and Case or Issue Reviews**

Managers will document site visits and reviews in writing to memorialize any understandings or agreements reached, decisions made, and outstanding items for each agenda item covered. The documentation prepared should be used as a starting point for the next review and may be shared as appropriate with the other managers involved in the case, the examination team, and the taxpayer.

