



Precedential Standard of Prior Year Audits

Issue

The IRS has developed alternative issue resolution methods to resolve issues at the examination level. The taxpayer and IRS expend much work and effort during the audit cycle on resolution. Today, the IRS does not necessarily honor the precedents established in prior year audits.

Background

The audit process is inherently adversarial. This can often create barriers to open communications, resulting in delays and wasted effort unless both sides work at building a strong, professional working relationship. Both the taxpayer and the IRS have a common goal of completing the audit in a fair, timely, and efficient manner. To this end, several innovative procedures have been established to improve the examination process that are designed to promote the concept of examination currency and create a positive environment for more thorough issue development and resolution. The recently announced "LIFE" examination process might be a major step in promoting this positive environment.

There are several alternative issue resolution methods available to the taxpayer and IRS. Methods to resolve issues at the examination level include Fast Track Mediation and Settlement, Accelerated Issue Resolution, Early Referral Authority, and Delegation Order 236.

Unfortunately, after the cycle closes, agreements reached with Examination are generally disregarded. A new audit team will not necessarily honor the resolution of issues in prior year audits. Certainly, if facts and circumstances change, the IRS is obligated to revisit the issue. However, if the facts and circumstances have not changed, it is extremely detrimental to the taxpayer and the IRS's reputation and relationships to not honor the precedent.

Policy Considerations

Many taxpayers spend the majority of an audit cycle rehashing issues that had been previously resolved to the satisfaction of a prior IRS team. In keeping with the spirit of Alternative Issue Resolution methods developed by the IRS, accepting a precedent established in a prior audit cycle when the facts and circumstances do not change would increase goodwill and efficiencies of an audit.

The "LIFE" examination process may be used for this process. A standard clause in the sample memorandum of understanding provides that the taxpayer will compute (and agree to) rollover and recurring items, which implies that prior resolution will be followed in the LIFE examination. However, the principle is not made explicit and the LIFE process is not guaranteed from year to year.

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Recommendation

The SVTDG recommends that the IRS issue an announcement indicating its intention to honor precedential standards established in prior audit cycles if the facts and circumstances of the resolution remain unchanged. The IRS should explicitly state that rollover and recurring adjustments would be accepted by the IRS in the LIFE examination.