



Managing US Tax Litigation and Controversy - Selected Topics

Presentation for the 2024 Tax Expo, TXCPA Houston

Paul Masters, Dan Sosna, Jenny Joy, Bill Grout, Marian Briscoe
Shell Tax

Agenda

- ❑ IRC Section 7525 Tax Practitioner Privilege
- ❑ IRC Section 162(f) Tax Deductibility of Fines & Penalties
- ❑ Managing an Audit, Collaborative Compliance



IRC Section 7525 Tax Practitioner Privilege

Attorney -Client Privilege: In General

- In General
 - Protects the confidentiality of communications between lawyers and clients regarding legal advice
 - Absent waiver, generally provides absolute protection from disclosure to 3rd parties
- Key Elements
 - Element #1: “A communication”
 - Verbal; written (emails, letters, memoranda, etc.)
 - Element #2: “Made between counsel and client”
 - Privilege may be waived if communication is shared with non-essential 3rd parties
 - Element #3: “In confidence”
 - Confidential when made and intended to remain confidential
 - Element #4: “For the purpose of seeking, obtaining or providing legal assistance”
 - Only legal advice is protected by the AC privilege



Section 7525: Privilege Relating to Taxpayer Communications

- Prior to 1998, no privilege protected communications between non-lawyers and taxpayers
- IRS Restructuring and Reform Act of 1998 added Section 7525 to the Code
 - Limited protection for communications between a “federally authorized tax practitioner” and a taxpayer to the extent the communications would be considered privileged if between an attorney and taxpayer
 - Communication for the purpose of securing “tax advice”
 - Communication must be made in confidence (i.e., disclosure may result in waiver)
- “Federally authorized tax practitioner” = any individual authorized under federal law to practice before the IRS (e.g., CPAs)
 - Section 10.3 of Circular 230, *Regulations Governing Practice before the Internal Revenue Service*
- “Tax Advice” = Advice provided by a practitioner within the scope of the person’s authority to practice before the IRS
 - Applies to information the taxpayer provides to facilitate tax advice and the tax advice the practitioner provides to the taxpayer

Section 7525: Limitations and Exceptions

- Applies to civil administrative proceedings with the IRS (e.g., IRS examinations, IRS Appeals) and to tax litigation before the US Tax Court and other federal courts
- Does not apply to non-tax proceedings, criminal tax proceedings, or any SALT matters in state court
- Does not apply to communications regarding strictly tax return preparation, but rather tax planning advice, tax consulting, audit defense, and other similar communications
- Does not apply to written communications in connection with the promotion of any “tax shelter”
 - “Tax shelter” is any entity, plan, or arrangement a significant purpose of which is the evasion or avoidance of federal income tax (Section 6662(d)(2)(C)(ii))
 - No analogous exception under the AC privilege
 - Impact on tax advice provided in connection with ordinary business transactions
- Other considerations
 - Limited case law
 - Whether section 7525 applies is a legal question



IRC Section 162(f) Tax Deductibility of Fines and Penalties

What is IRC Section 162(f)?

General rule under Section 162: There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. **Subject to various exceptions—Supports Non-Tax Public Policy Based Rules; No tax benefit for breaking a law.**

Section 162(f) - Denies a federal corporate income tax deduction for amounts paid for

- Certain fines, penalties and other amounts
- Paid to or at the direction of governmental and other identified entities
- For violating or potentially violating a law.

Provides for exceptions to allow deduction for amounts constituting:

1. Restitution
2. Remediation
3. Coming into compliance with the law

What, Why, Who has changed?

Tax Reform changes to Section 162(f)

1. **Broadened scope of what constitutes:**

- “fine or penalty”,
- “governmental”
- “violation of law”

2. **Codified exceptions** to the disallowed deduction based on case law and IRS guidance.

3. Final Regulations: **Must Substantiate Exceptions with Explicit Documentation**

4. New Reporting requirements for the Governmental payee.

Applies only to orders and agreements that are binding on or after January 1, 2022.

What is our goal? Value Preservation via Tax Deductions for Excepted Amounts. Tax has material dependency on other functions- Primarily Litigation team but also Finance.



Exceptions to the General Rule of Deduction Disallowance

Amounts Paid or Incurred for a violation of a law are deductible for:

- Restitution
- Remediation
- Coming into Compliance with the Law
- Private party lawsuits
- Certain Taxes due

Required Substantiation for Tax Deduction: Identification and Establishment

- Both requirements must be satisfied to meet exceptions
- Merely labeling and identifying an amount in a court order or settlement is insufficient.
- The order or judgement itself must identify the amount paid, the specific nature of damage caused and the purpose/use of the excepted payment.
- The taxpayer must establish the identified facts of the payment with documentary evidence.
- Tax should be brought into the process early to ensure requirements are met.



Managing an Audit, Collaborative Compliance

Shell's Responsible Tax Principle #4

Relationships with Authorities – We seek, wherever possible, to develop cooperative relationships with tax authorities, based on mutual respect, transparency and trust.

- Follow established procedures for all dealings with IRS
- Open and transparent with the IRS, responding in a straightforward and timely manner
- Endeavour to build a relationship of cooperative compliance
- Work to resolve any misunderstandings or disagreements
- Seek rulings based on full disclosure of facts
- Seek dialogue with Exam when there is uncertainty about tax rules

One Team Approach

Benefits for Exam

Efficiency: Implement a pre-audit Planning stage where resourcing can be adjusted to the desired scope of audit. Taxpayer to disclose material events, business changes, elections, etc.

Exam may request presentations on certain items.

Ability to focus resources on higher risk and value issues.

Transparent discussions based on trust throughout the planning, execution, and dispute resolution activities of the audit.

Keep Exam apprised of our evolving businesses as we go through the energy transition. (Energy Transition)

Benefits for Taxpayer

Efficiency: Implement a pre-audit Planning stage where recent filing information can be shared with Exam to facilitate audit planning.

Exam to also disclose items they wish to audit so data collection, presentation preparation and resourcing can commence on Shell's side.

Timeliness and access to relevant staff and documentation.

Transparent discussions based on trust throughout the planning, execution, and dispute resolution activities of the audit

Q & A

