



# Alternative Dispute Resolution Processes

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**SJSU Tax Institute**

**November 18, 2008**

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PROCESS	AUTHORITY	DESCRIPTION
<b>PRE-EXAMINATION</b>		
<b>Private Letter Ruling</b>	Rev. Proc. 2008-1	Written statement issued to a specific taxpayer that interprets and applies tax laws to the taxpayer's specific set of facts
<b>Pre-Filing Agreement</b>	Rev. Proc. 2007-17	Pre-filing resolution of tax controversies and production of closing agreements for (1) specific factual situations where there exists established legal principles, (2) issues involving methodologies, (3) issues under the jurisdiction of other IRS divisions (e.g., international issues); can cover a 4-year period beyond the current tax year; can include the execution of a Closing Agreement with the IRS
<b>Advanced Pricing Agreement</b>	Rev. Proc. 2008-31	Permits the IRS and taxpayer to agree to on a transfer-pricing methodology prior to filing the tax return
<b>Compliance Assurance Program (CAP)</b>	Announcement 2005-87	Program through which the IRS and the taxpayer agree to contemporaneously exchange information regarding completed transactions to reduce taxpayer burden, eliminate uncertainty in tax treatment prior to the filing of a return, and eliminate or reduce the need for post-filing examinations; requires taxpayer to enter into a Memorandum of Understanding with the IRS
<b>Industry Issue Resolution</b>	Rev. Proc. 2003-36	IRS resolution of frequently disputed or burdensome tax issues that affect a significant number of business taxpayers through the issuance of guidance; guidance may be in the form of a regulation, revenue procedure, revenue ruling or notice
<b>Automatic Consent for Change in Accounting Method</b>	Rev. Proc. 2008-52	Provides the procedures by which a taxpayer may obtain automatic consent for a change or method for accounting
<b>EXAMINATION</b>		
<b>Audit Planning Process</b>	IRM 4.46.3	Participate in the IRS's examination planning through informal meetings with the IRS during the initial planning phase to discuss commitments and to establish a cooperative working relationship with mutual goals including the efficient and timely completion of the examination
<b>IDR Management Process</b>	IRM 4.46.4.4	Discuss IDRs with the examination team to ensure coordination and completeness of requests and responses, establish realistic deadlines, and maintain rapport with the examination team
<b>Opening Conference</b>	IRM 4.46.3.3.3	The opening conference is the first formal meeting with the IRS and should be used to confirm commitments made during preliminary meetings and to discuss the examination process
<b>Delegation Order 4-24 (Formerly DO 236)</b>	IRM 4.46.5.5.3	Provides case managers settlement authority on recurring issues for a taxpayer provided that issues were settled in Appeals for the same taxpayer or another taxpayer directly involved in the same transaction in a prior or later period

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PROCESS	AUTHORITY	DESCRIPTION
<b>EXAMINATION (CONTINUED)</b>		
<b>Delegation Order 4-25 (Formerly DO 247)</b>	IRM 1.2.43 .6	Provides case managers settlement authority in accordance with Appeals Settlement Guidelines provided there is review and concurrence by the Appeals Issue Coordinator
<b>Limited Issue Focused Examination (LIFE)</b>	IR-2002-133 IRM 4.51.3	Process through which the IRS and the taxpayer agree to materiality limitations below which the IRS will not raise issues and the taxpayer will not assert claims, thereby limiting the scope of the IRS's examination; requires taxpayer to enter into a Memorandum of Understanding with the IRS
<b>Accelerated Issue Resolution (AIR)</b>	Rev. Proc. 94-67	Advances the resolution of the same or similar issues arising in a tax period under examination to subsequent tax periods
<b>Early Referral to Appeals</b>	Rev. Proc. 99 28	Process to refer contested issues to Appeals prior to the completion of the examination
<b>Closing Agreement</b>	IRC § 7121 IRM 8.13	A written agreement entered into by the taxpayer and the IRS that is final and conclusive with respect to an internal revenue tax for any issue and/or period covered by the agreement
<b>Fast-Track Settlement</b>	Rev. Proc. 2003-40	Non-binding negotiation process between the taxpayer and revenue agents or Team Managers with the assistance of an Appeals Official acting as a neutral third party
<b>APPEALS</b>		
<b>Traditional Appeals Process</b>	IRM 8.1.3	Formal IRS process to fairly and impartially resolve tax controversies without litigation
<b>Post-Appeals Mediation</b>	Rev. Proc. 2002 44	Non-binding process that utilizes a mediator (an Appeals employee and, potentially, a non-Appeals co-mediator) to assist Appeals and the taxpayer in reaching a negotiated settlement
<b>Post-Appeals Arbitration</b>	Rev. Proc. 2006-44	IRS and taxpayer jointly agree to binding arbitration on unresolved factual issues
<b>Closing Agreement</b>	IRC § 7121 IRM 8.13	Written agreement entered into by the taxpayer and the IRS that is final and conclusive with respect to an internal revenue tax for any issue and/or period covered by the agreement
<b>LITIGATION</b>		
<b>Pre-Trial Closing Agreement</b>	IRM 8.4.1.3	Appeals and Chief Counsel maintain settlement authority over docketed cases



# Alternative Dispute Resolution Processes (ADR)

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- Pre-Filing Agreements (PFA)
- Advanced Pricing Agreements (APA)
- Compliance Assurance Program (CAP)
- Industry Issue Resolution (IIR)
- Continual Improvement of Examination Process
- Delegation Order 4-24 - Application of Appeals Settlement to LMSB Taxpayers
- Delegation Order 4-25 - Settlement Authority for Coordinated Issues
- Limited Issue Focused Examinations (LIFE)
- Advance Issue Resolution (AIR)
- Early Referral to Appeals
- Fast Track Settlement
- Post-Appeals Mediation
- Competent Authority Process

# PRE-FILING AGREEMENTS (PFA)



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- Rev. Proc. 2007-17 describes process
- PFA Program allows TP to resolve issues with IRS in tax years for which the return is not yet due, but the transaction under consideration has been completed.
- Agreement may be taken forward for Four years
- PFA may also determine methodology for use in determining item of income or deduction



# PRE-FILING AGREEMENT

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- For International issues, Industry Director must receive approval from ACCI before accepting them into the PFA program
- At the close of the process, ACCI must also acquiesce in the result



# PRE-FILING AGREEMENT

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- Forbidden Issues
  - Transfer pricing (APA has jurisdiction)
  - Change of Method of Accounting
    - But can have PFA on implementation of Sec. 481 adjustment on approved change
  - Issues re: annual accounting period
  - Reasonable cause issues
  - Penalties or criminal sanctions
  - Issues which are or will be the subject of a TAM, PLR, or Determination Letter



# PRE-FILING AGREEMENT

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- Forbidden Issues (Cont'd)
  - Proposed resolution contrary to TAM, etc.
  - Proposed response to TAM contrary to TP's position
  - Issue in litigation between TP and IRS
  - Issue designated for litigation
  - Tax Shelter whose purpose is tax avoidance
  - Whether TP is common law employer
  - Transaction not completed



# PRE-FILING AGREEMENT

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- Vetting Process for PFA acceptance
  - Industry Director consults w/ Associate Office on whether issue jurisdictionally appropriate and in the best interest of tax administration
  - ID also considers whether resources are available
  - Continued coordination with Assoc Offices to insure issue still suitable as it develops
  - ACCI approves Closing Agreement, others receive post execution
- User fee is \$50,000 per issue



# PRE-FILING AGREEMENT

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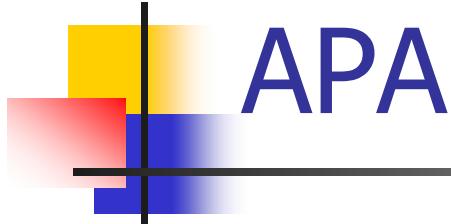
- Acceptance of Issues into PFA Program
  - All domestic issues are eligible if they involve well settled law and a purely factual dispute
  - Industry Director must consult with Associate Chief Counsel with subject matter jurisdiction over the issue before accepting issue into the program

# Advanced Pricing Agreements (APA)



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- Process described in Rev. Proc. 2006-9 and Rev. Proc. 2008-31
- Under jurisdiction of ACCI
- APAs apply to transfer pricing in future years
- APAs can apply to
  - Attribution of profits to PE
  - Determining income EC to US Trade or Business
  - Determining income from sources partially within and without US
- APA may be unilateral or bilateral
- Result may be rolled back to prior years with Exam's consent, as long as it does not decrease income reported on filed year where APA is unilateral



- Requesting an APA
  - TP asks for a pre-filing conference
  - TP must provide names of attendees and outline of issues to be discussed
  - For IRS, attendees include APA staff, RA or AO (if prior audit), local counsel (if requested by RA or AO), and Competent Authority (if bilateral)



- Formal Submission
  - TP must fully describe transaction and submit documents needed to evaluate
  - TP must supplement submission if needed to correct or update material facts
  - Request should be for at least 5 years or state why shorter period covered
  - Should be at least 3 unfiled years covered by date of APA completion, so may need to expand



# APA

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- Fees for use of APA process range from \$22,500 to \$50,000, depending on gross income of TP, size of the transaction, whether the request is new or a renewal, and whether TP is making more than one request
- TP can withdraw from APA, but fee will usually not be refundable



# APA

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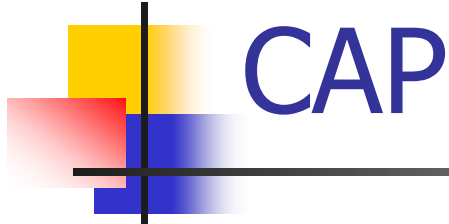
- If successfully completed, APA legally binding on TP and IRS
- Once APA signed, IRS cannot challenge TP method. Can only check compliance with terms, correctness of supporting data, satisfaction of critical assumptions, and accurate application of TP method
- Cannot introduce non factual APA data in Court or administrative proceeding of which the APA period is not at issue



# Compliance Assurance Program (CAP)

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- Announcement 2005-87 describes pilot program announced in 2005
- Goal of program
  - Work with LMSB TPs to identify and resolve issues prior to filing return in order to shorten cycle time
- Can only evaluate completed transactions affecting tax liability



- Requirements

- TP must fully disclose information on completed business transactions and anticipated tax treatment
- TPs resolving all material issues are assured return will be accepted as filed
- If not all issues are resolved, program identifies issues needing to be resolved on audit

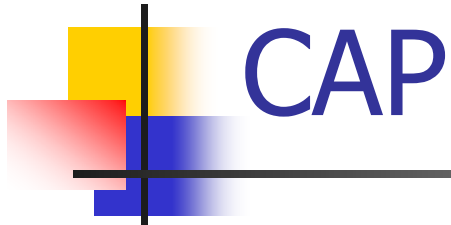


# CAP

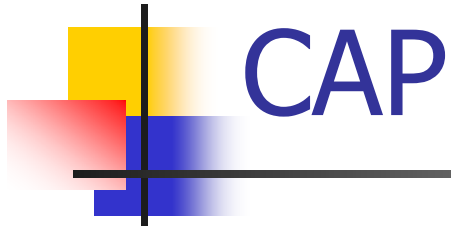
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- Process

- Parties appoint primary contact points and sign MOU on how to process work
- As they agree to treatment of material issues, they sign Issue Resolution Agreements
- Parties may use FASTTRACK, etc. to expedite resolution during CAP process
- At close of tax year, parties enter into closing agreement on all agreed issues
- If all material issues agreed, IRS assures TP in writing that return will be accepted as filed, subject only to post filing review



- Process (Cont'd)
  - If cannot agree to all issues, parties sign Form 906 on agreed issues, and IRS assures TP that subject to post filing review, that only those issues that the parties identify will be audited
  - Post filing review of return is conducted by IRS and TP within 90 days of filing



- If items on filed return not reported consistently with Form 906 or if issues on return had not been adequately disclosed, those will be subject to audit
- Only reopen if circumstances of Rev. Proc. 2005-32 apply

# Industry Issue Resolution (IIR)



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- Rev. Proc. 2003-36 describes Industry Issue Resolution process
- Provides a mechanism whereby business TPs and Industry Groups can bring frequently disputed or burdensome issues to IRS for resolution through Administrative or Published Guidance
- Must impact significant number of TPs
- Applies to both large and small business TPs



# IIR

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- Issues accepted should have at least two of the following:
  - Proper tax treatment of common fact pattern is uncertain
  - Uncertainty results in frequent, repetitive examinations
  - Uncertainty burdens TPs
  - Issue is significant and impacts large number of TPs in an industry or across industry lines
  - Issue factually intensive and understanding industry practice and views helps IRS determine proper treatment



# IIR

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- Issues Not Suitable
  - Issues impacting few TPs
  - Issues primarily under jurisdiction of Division other than LM or SB
  - Tax motivated transactions
  - Transfer pricing or International treaties



# IIR

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## ■ Process

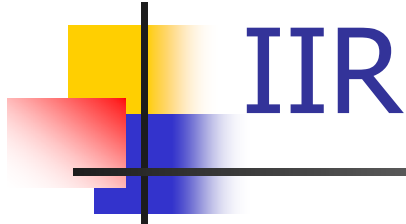
- Applications accepted all year
- Service reviews applications after March 31 and August 15, and recommends for inclusion in Guidance Priority List
- CC and Treasury determine if placed on GPL
- IRS notifies Applicant if accepted for GPL
- List of accepted issues to IIR program listed on IRS.gov



# IIR

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- Process (Cont'd)
  - If issue accepted, team formed to include CC, Treasury, Appeals, LM or SB
  - Team may ask TP group for information
    - Information received may be subject to FOIA
  - Applications for IIR are public documents
    - TPs should refrain from putting TP specific information in submission



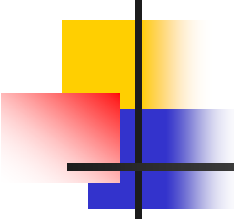
- Submission of Issue Should Include
  - Issue statement
  - Why issue is appropriate for IIR process
  - Need for guidance explained
  - Number of TPs affected by issue
  - Contact person for additional information
  - Recommended resolution



# Continual Improvement of the Examination Process

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- Opening conferences and audit planning
- Responses to IDRs
- Issue management strategy
- Appropriate Resolution of the one and tier two issues
- The Currency Initiative
- Use of specialists, including the role of International Examiners
- Broader corporate and partnership coverage
- Effective Penalty Administration



# Delegation Order 4-24 - Application of Appeals Settlement to LMSB Taxpayers

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- The purpose of Delegation Order 4-24 is to assist in relieving taxpayer burden and reducing both Service and taxpayer costs when similar issues exist which are beyond LMSB's resolution capabilities.
- Delegation Order 4-24 gives team managers limited settlement authority with respect to certain issues. It does not restrict nor reduce the issue resolution capabilities otherwise vested with team managers.



# Delegation Order 4-24 - Application of Appeals Settlement to LMSB Taxpayers

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Delegation Order 4-24 settlement authority may be exercised only if all of the following factors are present:

- a. The issue is in a LMSB case under the jurisdiction of the Compliance function;
- b. A settlement has been effected by Appeals in the same, previous, or subsequent tax period;
- c. The facts are substantially the same as the facts in the Appeals settled tax period;
- d. The legal authority is unchanged;
- e. The underlying issue was settled by Appeals independently of other issues; and
- f. The issue was settled in Appeals, with respect to: The same taxpayer (including consolidated and unconsolidated subsidiaries), or another taxpayer who was directly involved in the same transaction or taxable event in the settled period.

# Delegation Order 4-24 - Application of Appeals Settlement to LMSB

## Taxpayers

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- Under Delegation Order 4-24, the exercise of settlement authority by LMSB is intended to apply only where there was a prior Appeals settlement involving the same or related taxpayer.
- Authority to accept settlement is delegated to the LMSB Team Manager
- The taxpayer has no right to appeal the team manager's decision if the team manager declines to exercise team manager settlement authority. However, the taxpayer can request a conference with the team manager and/or territory manager to discuss the reasons this authority is not being exercised.
- Settlement results in a Closing Agreement



# Delegation Order 4-25 - Settlement Authority for Coordinated Issues

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- Delegation Order 4-25 grants settlement authority for coordinated issues with Appeals Settlement Guidelines. Settlement authority is available for these types of issues, regardless of the amount.
- Delegation Order 4-25, rather than Delegation Order 4-24, applies whenever coordinated issues are being considered for settlement. Since Delegation Order 4-24 does not specifically state that team managers have the authority to settle technical guidance coordinated issues previously acted upon by Appeals, these kinds of issues may be settled only if Delegation Order 4-25 applies.
- Technical guidance coordinated issues can be settled by the team manager only if Appeals has issued written settlement guidelines.



# Delegation Order 4-25 - Settlement Authority for Coordinated Issues

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- Form 5701 (Notice of Proposed Adjustment) reflecting the full adjustment should be given to the taxpayer. A statement should be included on Form 5701 indicating that there is a settlement guideline on the issue. Within 30 days, the taxpayer will be expected to respond in writing either agreeing to the adjustment or presenting their arguments.
- The team and the team manager will formulate the settlement position with assistance and participation from the Technical Advisor (TA) and the Appeals Issue Specialization Program (ISP) coordinator.
- The service will pursue settlement attempts through appropriate discussions with the taxpayer and consultation with the TA and the Appeals ISP coordinator.
- The taxpayer should be informed that a settlement position is being formulated.
- The settlement position will be reflected on a Form 5701S (amended to indicate the settlement offer)



# Delegation Order 4-25 - Settlement Authority for Coordinated Issues

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- If the taxpayer agrees to the settlement, then the Proposed settlement and Closing Agreement approved by the Technical Advisor (ISP) or IFASP Specialist and Appeals ISP Coordinator
- If the taxpayer agrees to the settlement, the Delegation Order permits the use of either a Form 870-AD or a closing agreement in finalizing the settlement. In most circumstances, the use of a closing agreement will be preferred.



## Delegation Order 4-25 - Settlement Authority for Coordinated Issues

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- If the taxpayer does not agree with the proposed settlement, the full adjustment (unsettled position) will be treated as an unagreed issue and closed to Appeals. Both the Forms 5701 and 5701S should be included in the case file being transferred to Appeals.
- Unless the taxpayer presents new information or the facts and circumstances change, Appeals will not offer a new settlement on this issue to the taxpayer.



# Limited Issue Focused Exam (LIFE)

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- An alternative approach to traditional full scope examination
- Key Features
  - TP must share responsibility for timely completing examination
  - Full risk analysis by whole team, including specialists
  - Use of materiality principals and compliance record of TP to limit scope



# LIFE Process

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- Key Features (Cont'd)
  - Established materiality thresholds to govern scope expansion
    - Applies to new issues raised by Examiner
      - Need Mgr approval
      - Applies to claims/affirmative issues raised by TP
  - MOU governs aspects of Examination
    - Many mandatory compliance checks may be waived



# LIFE Process

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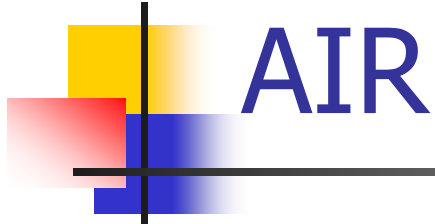
- Key Features (Cont'd)
  - IRS may terminate life process if TP does not meet it's commitments
    - Agent would then do full risk analysis
    - Agent would audit any new material issues found during life

# Advanced Issue Resolution (AIR)



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- Rev. Proc. 94-67 describes the process
- It allows CIC TPs to resolve issues arising from an audit and continuing in later filed but unexamined years
- Issue must arise in the audit of one tax period
- It must relate to a specific item affecting another tax period



- Excluded Issues
  - APA jurisdiction
  - TEGE jurisdiction
  - TEFRA issues
  - Issues contrary to TAM, PLR, or proposed TAM or PLR
  - Issue designated for litigation (or pending designation) in TP's case



- Issues Requiring Approval of Stakeholders
  - Industry Coordinated Issues
  - Appeals Coordinated Issues
  - Issue under Competent Authority for any year
  - Issue where TP{ got Comp Auth assistance in prior year
  - Issues in DOJ
  - Issues controlled by Division
  - Multi- Director cases
- No whipsaw issues unless all participate



# AIR

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- Process

- TP submits request to Case Manager of audit team which includes
- Discussion of material facts and law as applied to issue
- TP discloses whether it got or is asking for Comp Auth assistance on the AIR issue
- TP produces all documents relevant to the issue
- Statement that AIR process is not an Examination



# AIR

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- Process (Cont'd)
  - TP informed whether issue accepted
  - If accepted, TP submits Rev. Proc. 94-69 disclosure statement for issue
  - IRS develops issue and confirms facts consistent with current auditing standards
  - IRS must get concurrence of Comp Auth/ISP/other stakeholder before resolution reached
  - Resolution may not be hazards based unless D.O. 4-24 or 4-25 apply



- Process (Cont'd)
  - If AIR successful, Form 906 binds parties and must include:
    - TP acknowledgement that IRS relied on representations in AIR submission and other material and information provided by TP
    - TP treated the issue consistently for all covered years
    - Clear statement of resolution reached with computation sufficiently clear to determine effect of adjustment



# Early Referral to Appeals

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- Early referral is a process to resolve cases more expeditiously through LMSB and Appeals working simultaneously. This process is optional and may be requested by any taxpayer. A taxpayer may request early referral of one or more unagreed issues.
- A taxpayer may request early referral to Appeals of any developed, unagreed issue under the jurisdiction of LMSB arising from an audit. LMSB examiners should continue to develop issues that have not been referred to Appeals.
- Early Referral to Appeals does not alter LMSB's authority to audit the returns of a taxpayer as to other issues nor limit or expand LMSB's authority to resolve any other issues, including the authority in Delegation Order 4-24.



# Early Referral to Appeals

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Appropriate issues for early referral are limited to those that:

- a. If resolved, can reasonably be expected to result in a quicker resolution of the entire case;
- b. Both the taxpayer and LMSB agree should be referred to Appeals early;
- c. Are fully developed; and
- d. Are part of a case where the remaining issues are not expected to be completed before Appeals could resolve the early referral issue.

Appeals Industry Specialization Program (ISP) issues may also be referred under these procedures



# Early Referral to Appeals

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- A request for Early Referral must be submitted in writing by the taxpayer to the team manager. The team manager may suggest that a taxpayer make such a request.
- The request must describe the taxpayer's position with regard to the relevant early referral issues. The statement must contain a brief discussion of the material facts and an analysis of the facts and law as they apply to each early referral issue.



# Early Referral to Appeals

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- The team manager will, where feasible, notify the taxpayer of the decision to accept or reject an issue in the early referral request within 14 calendar days of receiving the request.
- There is no formal taxpayer appeal if the early referral request is denied in whole or in part; however, the taxpayer can request a conference with the territory manager of the team manager who denied the early referral request.
- If the team manager does not approve the early referral request with respect to any issue, the taxpayer retains the right to pursue the administrative appeal of any proposed deficiency related to that issue at a later time.



# Early Referral to Appeals

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- Established Appeals procedures, including those governing submissions and taxpayer conferences, apply to early referral issues, i.e., rules governing ex-parte communications with Appeals.



# Early Referral to Appeals

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- If an agreement is reached with respect to an early referral issue, generally a Form 906, Closing Agreement on Final determination Covering Specific Matters, is prepared.



# Early Referral to Appeals

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- If early referral negotiations are unsuccessful and an agreement is not reached with respect to an early referral issue:
  - a. Taxpayers may then request mediation for the issue, provided the early referral issue meets the requirements for mediation.
  - b. If mediation is not requested, Appeals will close the early referral file and return jurisdiction over the issue to LMSB. Appeals will send a copy of the Appeals Case Memorandum for the issue to the team manager.
- Appeals will not reconsider an unagreed early referral issue if the entire case is later protested to Appeals, unless there has been a substantial change in the circumstances regarding the early referral issue.



# Fast Track Settlements

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- FASTTRACK is a process where Appeals acts as a mediator, and tries to broker a settlement between the Taxpayer and Exam.
- FASTTRACK allows the LMSB to consider litigating hazards in resolving the issue
- The goal is to resolve the issue within 120 days of acceptance into the program
- All standard coordination process, i.e. Appeals Coordinated Issue, remain in effect during FASTTRACK



# FASTTRACK

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- Issue Eligibility

- Form 5701 must have been issued to TP.
- TP must have responded to Form 5701.
- Issue must be fully developed to allow for resolution within the 120 day period.
- No RAR or Statutory Notice of Deficiency may have been issued
- TP must agree to waive application of Appeals' Ex Parte communication rules



# FASTTRACK

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- Issues not eligible for FASTTRACK
  - Issue has been designated for litigation in the case.
  - Issue under consideration for designation in the case.
  - TP has requested Competent Authority relief
  - TP has requested Appeals/Competent Authority procedure under Rev. Proc. 2002-62
  - Non LMSB TP (with exceptions)



# FASTTRACK

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- Ineligible Issues (Cont'd)
  - Whipsaw issues
  - Not in interest of sound tax administration
  - Issue excluded from FASTTRACK by Chief Counsel Notice
  - No issue in case is eligible if any issue is ineligible

The logo graphic consists of a vertical black line on the left, a horizontal black line at the bottom, and three overlapping squares: a yellow one at the top left, a red one at the middle left, and a blue one at the bottom left. The word "FASTTRACK" is written in a bold, blue, sans-serif font to the right of the vertical line.

# FASTTRACK

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- Both TP and Exam must agree to any resolution
  - Appeals served role only as broker
  - Appeals has no independent authority to compel resolution
- If FASTTRACK process does not lead to resolution, TP may avail itself of the traditional Appeals process



# Post-Appeals Mediation

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- Mediation is an extension of the Appeals process
- Mediation is a nonbinding process that uses the services of a mediator, as a neutral third party, to help Appeals and the taxpayer reach their own negotiated settlement.
- The mediator will act as a facilitator, assist in defining the issues, and promote settlement negotiations between Appeals and the taxpayer.
- The mediator will not have settlement authority and will not render a decision regarding any issue in dispute.
- Mediation may be used only after Appeals settlement discussions are unsuccessful, and, generally, when all other issues are resolved but for the issue(s) for which mediation is being requested.



# Competent Authority Process

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- Role of the US Competent Authority
- Arbitration as a tax treaty process
- Improvement in timing and processing



# What does the future hold?

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- Budgets, management issues and recruitment to replace talent
- Asia developments: China and India
- Global trading initiatives
- Intermediaries



Thank You!

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