Comments Concerning Proposed Treasury Regulation 301.7430-7

The following comments are the individual views of the members of the Section of Taxation who prepared them and do not represent the position of the American Bar Association or the Section of Taxation.

These comments were prepared by individual members of the Committee on Court Procedure and Practice of the Section of Taxation. Principal responsibility was exercised by Charles J. Lavelle, Louisville, Kentucky, and Philip N. Jones, Portland, Oregon. Substantive contributions were made by Robin L. Greenhouse, Washington, D.C., and Robert T. Duffy, Charlotte, North Carolina. The Comments were reviewed by Professor Michael Mulroney, Philadelphia, Pennsylvania, of the Section’s Committee on Government Submissions and by Karen L. Hawkins, San Francisco, California, Council Director for the Committee on Court Procedure and Practice.

Although many of the members of the Section of Taxation who participated in preparing these Comments have clients who would be affected by the federal tax principles addressed by these Comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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I. Executive Summary

Section 7430 provides that certain taxpayers who are prevailing parties in tax controversies may be reimbursed for reasonable administrative and litigation costs. (Unless otherwise specified, section references are to the Internal Revenue Code of 1986, as amended). Section 3101(e) of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, generally provides that certain taxpayers will be treated as prevailing parties when the United States has rejected an offer to settle a tax case and the ultimate judgment of the court does not exceed the offer (and certain other requirements of section 7430 are met).

On January 3, 2001, the Internal Revenue Service and Department of the Treasury issued Proposed and Temporary Treas. Reg. § 301.7430-7, interpreting sections 7430(c)(4)(E) and 7430(g) which address qualified offers.

These comments address a number of areas we believe could be modified or clarified to further the goals of minimizing litigation regarding disputed issues of a substantive nature, as well as a taxpayer’s entitlement to fees. We believe that the regulations should make it clear that in cases involving multiple years and/or multiple taxes, the taxpayer should have the option to deliver one or more qualified offers relating to a single year and single tax, all years and all taxes, or any combination (Comment II.A.). We recognize that many of the taxpayers under the maximum net worth ceilings may not have sophisticated means at their disposal to make definitive tax calculations. Accordingly, we recommend that offers may provide for resolution based on a percentage of an adjustment or a fixed dollar amount of adjustment rather than the tax liability (Comment II.B.). If there are multiple taxpayers involved, such as a whipsaw situation, innocent spouse situation or divorced spouse situation, we believe that each taxpayer may file a qualified offer, irrespective of the existence or content of a qualified offer from the other party (Comment II.H.).

We have commented on three items which may be more mechanical than substantive. The Regulations provide an exception for cases awaiting other pending court or administrative proceedings (Comment II.C.); we asked for examples. Where issues are raised by the taxpayer after the 30-day letter is issued, the Regulations require that all relevant facts and law be presented; we believe that a more appropriate standard would be to provide the Service with sufficient information to make a thorough review or to provide the information that the taxpayer would file in support of a refund claim (Comment II.D.). Example 10 of the Regulation addresses the appropriate party to whom to deliver the qualified offer; we believe it would benefit from clarification (Comment II.G.).

The comments also address two other examples under the regulations. Example 6 illustrates the viewpoint that no fees are ever reimbursable if an issue is settled, no matter how close to trial the settlement occurs and no matter how much the government conceded. Our view is that as long as one issue is tried, then the taxpayer should be reimbursed for costs incurred after the qualified offer was made, even if some of the issues
are settled (Comment II.E.). Example 9 states that if a case is continued within 30 days of the calendar call that no subsequent offer may be a qualified offer; we believe settlement would be promoted, if the taxpayer were given a “new clock,” so that it could make qualified offers until 30 days before the new calendar call. This is the result under Example 8, if the case is continued before 30 days before the calendar call (Comment II.F.).

II. Comments

A. Years and Taxes Covered by a Qualified Offer. Treas. Reg. § 301.7430-7(b)(1) generally provides that to determine if a taxpayer is a prevailing party, “the liability for the type or types of tax and the taxable year or years at issue in the proceeding” is compared to the comparable liability under the judgment. The regulation also refers to Treas. Reg. §§ 301.7430-7(b)(2) and 301.7430-7(c) for further details. Neither of these regulations addresses situations involves more than one year or more than one tax in any more detail than Treas. Reg. § 301.7430-7(b)(1). None of the examples under Treas. Reg. § 301.7430-7(e) involve a more than one year or more than one tax. In a multi-year and/or multi-tax case, it is unclear whether a taxpayer may, or must, make a qualified offer on a single year/single tax basis, on an entire case basis encompassing all years and all taxes, or on any combination of some, but not all, years and/or taxes, at the taxpayer’s option.

Under the principles of Commissioner v. Sunnen, 333 U.S. 591 (1948), and similar cases, each tax liability for each tax year generally stands on its own. We believe that these principles should apply equally in qualified offer situations, so that taxpayers may make a qualified offer for a single tax for a single year, even in a multi-year and/or multi-tax case. Alternatively, we believe that in order to promote settlement of multi-year and/or multi-tax situations, the taxpayer should be able to make a single offer specifying a single net tax liability that includes as many of the years and taxes as the taxpayer desires, in whatever combination the taxpayer desires. Such an offer could cover some, but not all, of the years and taxes in an entire case: if it covered less than all the years or taxes in an entire case, one or more additional qualified offers could be made which covered some or all of the remaining years or taxes. We believe that these principles should apply whether the multiple years and/or multiple taxes are combined into a single docket or whether they are in multiple proceedings (the latter is consistent with section 7430(e)). We would recommend that each of these principles be adopted and that the regulations be clarified to explicitly permit the taxpayer, in a multi-year and/or multi-tax case, at its option, to make one or more qualified offers to cover a single tax for a single year or multi-year and/or multi-tax qualified offers covering some or all the years, whether in one or more proceedings. We recommend that one or more examples be given to illustrate this.
We understand that there is a concern that if a single issue affects more than one year or if a tax is dependent upon the resolution of another tax, then allowing the taxpayer to make an offer that covers some but not all the affected years or affected taxes would be inappropriate. If this is the case, we recommend that the regulation describe the circumstances where this concern arises and provide examples.

B. Making an Offer Other than in Dollars. Treas. Reg. § 301.7430-7(b)(3) requires that a qualified offer must state a dollar amount of the proposed tax liability. In some cases, the taxpayer might not have the resources available to calculate the tax liability, or the tax liability might be based in part on facts not yet known. Taxpayers should be permitted to offer a percentage of an issue, or a dollar amount of income adjustment. This change would promote settlement by giving taxpayers greater flexibility in making their offers.

C. Relationships with Other Court or Administrative Proceedings. In making the comparison of the amount of the qualified offer and the amount of the judgment discussed above, Treas. Reg. § 301.7430-7(b)(2) provides that “[t]he taxpayer’s liability under the last qualified offer is calculated without regard to adjustments to be fully resolved, by stipulation of the parties, through any other pending court or administrative proceeding.” (emphasis added). We recommend that the types of proceedings contemplated by the phrase “any other pending court or administrative proceedings” be described with more particularity and that examples be provided.

D. Issues Raised by Taxpayer after the 30-Day Letter is Issued. Treas. Reg. § 301.7430-7(c)(4) addresses issues raised by a taxpayer after the issuance of the 30-day letter. The regulation requires that the offer will not be deemed to be a qualified offer until such time that the taxpayer has adequately explained the issue, together with the facts and legal arguments supporting it. This seems like a reasonable concern, but the regulations require disclosure of “ALL relevant information” (emphasis and upper case added). That phrase would allow the Service to require a large volume of disclosure which, if not fully provided, would prevent the offer from becoming a qualified one. A somewhat lower standard should be imposed. The taxpayer should be required to disclose sufficient information that would permit the Service to carry out a reasonably thorough review of the issue (and/or disclose information that would be sufficient to file a valid claim for refund). Such language would be open to interpretation, but it would be preferable to the “all relevant information” standard. The standard proposed by the regulations seems to draw the line entirely in favor of the Service, and would prevent an offer from becoming a qualified offer if ANY small item of information is omitted, as long as the omitted information has some small degree of relevance. If complied with, this standard would often result in the Service having substantially more detail and information on this issue than on issues that it had thoroughly audited and for which it had received complete answers in response to its information document requests.
E. **Example 6.** Section 7430(c)(4)(E)(ii)(I) provides that qualified offers do not apply to “any judgment issued pursuant to a settlement.” Example 6 of Treas. Reg. § 301.7430-7(e) (which builds on fact patterns set forth in Example 4 and 5 of Treas. Reg. § 301.7430-7(e)) essentially involves the following situation: the taxpayer makes a qualified offer which covers the three unresolved issues in the case. The government rejects the offer. The taxpayer and the government ultimately settle issues one and two; issue three is tried. The aggregate liability for these three issues from the settlement and the litigation is less than the liability offered in the qualified offer. Example 6 provides that the only reimbursable costs are those incurred with respect to issue 3 after the qualified offer was made. None of the costs associated with issues 1 and 2 are reimbursable. While the example does not explicitly so state, it appears clear that this would be the case even if the settlement were a complete concession by the government and even if it took place “on the courthouse steps” after all of the cost and expense of trial preparation had occurred.

We believe that the policy of encouraging settlements supports the reimbursement of expenses for issues 1 and 2, and is consistent with the statute. If the taxpayer makes an offer which ultimately results in the settlement of some of the issues, early settlement should be promoted by subjecting costs to reimbursement. This would put an incentive on the government to settle at an earlier time, rather than later, after the trial preparation costs had been incurred. In order for the government to be at jeopardy for these costs, it must have determined that the taxpayer’s offer was inadequate and taken at least some of the case through trial; thus, not only could it have avoided the costs entirely if it had initially recognized that the offer was adequate, it still had the opportunity to avoid the costs entirely by settling all the issues (at any time prior to a judgment being issued). If all issues are settled, then no expenses would be reimbursed under the qualified offer provisions, because the judgment would have resulted from a settlement. However, if one issue is tried, we believe that the judgment was not “issued pursuant to a settlement.” We do not believe the statutory language dictates that the approach of the regulations be followed: that the judgment be divided between the portion attributable to the settled issues (which expenses are not reimbursable) and the portion attributable to the tried issues (which expenses are reimbursable.) We believe that the statutory language supports the interpretation that a judgment is not “issued pursuant to a settlement” unless all issues are settled. The purpose of the statute is to eliminate litigation. If one or more issues have been tried, then litigation has not been eliminated. Under those circumstances there has not been a settlement and the judgment has not been issued pursuant to a settlement.

The regulations are clear that even if a taxpayer does not receive reimbursement from a qualified offer, it may qualify for reimbursement under other provisions of section 7430. We believe that this may not adequately address the issue. Assume
that all three contested issues in our example are true “50/50” issues. It is unlikely that attorney fees will be reimbursable when all the issues are toss-ups. Accordingly, if the taxpayer did not receive reimbursement on issues 1 and 2 from its qualified offer because those issues were settled, it is unlikely that it would receive attorneys fees from any other source in Section 7430.

F. Example 9. Section 7430(g)(2)(B) states that the qualified offer period (the period during which an offer may be made) ends “on the date which is 30 days before the case is first set for trial.” It is clear that if the calendar call for a trial session is set for July 1, that an offer made on June 15 is too late to qualify. Example 9 of Treas. Reg. § 301.7430-7(e) states that once a case gets within 30 days of the call of a calendar, then a qualified offer may never be made, even if the case is continued to a later call of the calendar. Thus, on the above facts, if, after May 31, the case is continued, no offer made after May 31 would be qualified. The regulations provide that if an offer were made after May 31, but before a continuance were granted, the offer is not a qualified offer. This problem is particularly acute if the case is continued after it is first set for trial in order for the case to be considered by the Internal Revenue Service Office of Appeals. We believe that settlement is promoted by giving the taxpayer a “new clock” to permit it to make qualified offers until 30 days prior to the call of the calendar. This is the same result that would have resulted if the continuance had been granted before June 1. See Example 8 of Treas. Reg. § 301.7430-7(e).

G. Example 10. Treas. Reg. § 301.7430-7(c)(1) provides, among other things, that a qualified offer must be made by the taxpayer to the United States during the qualified offer period. Treas. Reg. § 301.7430-7(c)(2)(i) provides that a qualified offer is made to the United States if it is delivered to the office or personnel having jurisdiction over the tax matter at issue. If the proper person cannot be determined, then the regulations list the persons to whom to send the qualified offer. Example 10 of Treas. Reg. § 301.7430-7(e) provides an example where the Examination Division issued a 90-day letter. The taxpayer timely filed a Petition, and, the next day, mailed an offer to the office that issued the notice of deficiency. That office transmitted the offer to the field attorney with jurisdiction over the Tax Court case. We believe that this Regulation should make it clear that under Treas. Reg. § 301.7430-7(c)(2)(i)(B) the taxpayer could have delivered the offer to the Office of Chief Counsel even if the taxpayer knew the office issuing the 90-day letter. It might also be helpful to identify when, if ever, the office issuing the 90-day letter ceases being the office having jurisdiction over the tax matter.

H. Multiple Taxpayer Situations. The Treasury Decision states that the regulations apply to multiple taxpayer situations such as joint returns. Presumably, it also applies to affiliated groups filing consolidated returns. The regulations do not address whipsaw situations, innocent spouse situations or divorced spouse situations. We believe that in each of these latter situations, any of the parties
should be able to make a qualified offer as to that taxpayer’s liability without regard to the actions of the other; i.e., one taxpayer may make a qualified offer in any amount whether or not the other makes a qualified offer and, if both make qualified offers, it is irrelevant whether or not the sum of the two qualified offers would equal 100% of the tax at issue.

The taxpayers involved have net worths below the maximum allowable, which often indicates a lower level of tax sophistication or savvy. Each of the situations (whipsaw, innocent spouse and divorced spouse) often involves a level of adversity, if not hostility, in the parties’ relationship; accordingly, there is often not cooperation or coordination of the parties. Often, with less sophistication and/or non-cooperative parties, the IRS will have more facts and better legal analysis, so that it is in the best position of any of the three parties to evaluate the merits of the case.

Let us illustrate some possible scenarios. A sells his or her sole proprietorship to B. The IRS audits A and, as a result of a valuation or allocation dispute, audits B. The IRS views itself as a stakeholder as to the outcome, but independently evaluates that it has an 80% chance of success against A, and it has a 20% chance of success against B. We believe that B should be able to make a qualified offer of 20% of the tax involved. If the Service accepts, then it will ultimately collect between 20% and 120%. Based on these facts, the IRS should seek 80% in settlement with A; and, if A evaluates the case as the Service does, A will settle and the Service will collect 100% of the tax. If this is an “all or nothing” issue which is litigated, the Service could collect 120% of the tax. There is no policy reason to subject B to the time, effort and cost of a trial where it was willing to make a reasonable offer that fully evaluated the hazards of litigation. Depending on the precise facts, B may not otherwise be able to recover legal fees as a prevailing party.

Alternatively, on these facts, if A makes a qualified offer of 80% of the tax, the Service should accept it. In an “all or nothing” issue, the Service may reject the offer because it will prevail 100% against A and will likely get nothing from B in litigation and believes it cannot settle with B. In that instance, the Service should bear the burden, if it requires a taxpayer to litigate who makes a full and fair offer and comes out no worse than the offer.

With taxpayers who meet the net worth requirement, the issues will often not be novel. Litigating such a tax case nonetheless often requires taking time off work, dealing with a high level of anxiety and incurring extraordinary legal and accounting fees. Accordingly, it is appropriate to minimize the economic burden of legal fees for taxpayers who make reasonable offers that fully evaluate the merits of the case.

Similarly, if a spouse is “innocent,” he or she would have no liability for the other spouse’s tax liability. If the innocent spouse made a qualified offer, it should be
accepted or the Service should pay the legal fees if the litigated liability was less than the offer.

The same reasoning applies to divorced spouses. Suppose one former spouse deducts an “alimony” payment which the recipient spouse does not treat as includible. Either spouse should be able to make a qualified offer, and the Service should risk paying legal fees if it rejects an adequate offer.