Where Do We Go From Here: A Comparison of Alternatives When You and the IRS Agree to Disagree

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The Audit is Over – Now What?

When an IRS examination is complete and the taxpayer does not agree to the changes proposed by the examiner, the avenues for contesting proposed adverse determinations are:

Dispute Resolution Available Without Litigation

• Appeals Division
• Alternative Dispute Resolution

Litigation Forums

• Tax Court
• United States District Court
• United States Court of Federal Claims
### Dispute Resolution Available Without Litigation

<table>
<thead>
<tr>
<th><strong>Pros</strong></th>
<th><strong>Cons</strong></th>
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<tr>
<td>• Significantly lower cost to the taxpayer to resolve the dispute.</td>
<td>• Interest is accruing, compounding daily.</td>
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<td>• Delays issuance of a Notice of Deficiency.</td>
<td>• Appeals may find something the examiner missed.</td>
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<td>• Delays required payment or collection action.</td>
<td>• Allows IRS to identify weaknesses in the taxpayer’s position.</td>
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<td>• Allows taxpayer to determine strength of examiner’s position.</td>
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### Appeals Division

The Appeals Mission is to resolve tax controversies, without litigation, on a basis which is fair and impartial to both the Government and the taxpayer and in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the Service.

The Appeals Division has been delegated authority to consider most, but not all, proposed additions to tax, interest, and penalty. For example, Appeals does not have authority to settle cases in which a recommendation for criminal prosecution is pending. See Treas. Reg. §601.106(a)(2) – (4) for the complete list of circumstances in which Appeals does not have settlement authority.
Appeals Division (cont.)

Appeals responsibilities include the administrative determination of liability, including additions to tax and penalties for the following types of cases:

1. income, estate, gift, employment and excise taxes;
2. collection due process;
3. collection appeals program;
4. offers-in-compromise;
5. penalty appeals;
6. abatement of interest;
7. administrative costs under IRC Section 7430;
8. jeopardy levies;
9. recommendations concerning settlement offers in refund suits;
10. IRC 534(b) letters;
11. refund claims including Joint Committee cases; and
12. overassessments in which a taxpayer appeals the decision of a compliance area director, or a campus director.

Appeals Division (cont.)

Appeals is independent of any other IRS office and serves as an informal administrative forum for any taxpayer who disagrees with an IRS determination.

– No ex parte communication is permitted between Appeals personnel and other Internal Revenue Service personnel to the extent that such communications appear to compromise the independence of Appeals personnel. See Section 1001(a) of the Internal Revenue Service Restructuring and Reform Act of 1998.
Appeals Division (cont.)

In most cases, an appeal is handled by a single appeals officer in the local Appeals office where the taxpayer resides or has her principal place of business.

A taxpayer must request Appeals Division Consideration. Treas. Reg. §601.106(a)(1)(iii). Although a written request for Appeals consideration is always a best practice, it is required if the total proposed additional tax, interest, and penalty exceeds $10,000 for any taxable period.

The Appeals Division has authority to settle cases:
(1) not docketed in the Tax Court;
(2) docketed in the Tax Court for a period of 4 months after Appeals receives the case from District Counsel unless the Notice of Deficiency was issued by Appeals.

Appeals Division (cont.)

Appeals Officers must prepare “Appeals Case Memos”, which explain and support the recommended disposition of the case.

Practitioners should, in essence, write the Appeals Case Memo for the Appeals Officer.
**Appeals Division – Appeals Case Memo**

- **Summary and Recommendation**: Includes a brief summary of the legal issues, hazards to the government, recommendation for resolution, and rationale for recommendation.
- **Factual Background**: Identifies only relevant facts and does not include any legal analysis.
- **Discussion and Analysis**: Identifies each proposed adjustment identified by the examiner and explains in clear and concise language why each item should be affirmed or reversed, addressing both law and facts for each proposed change. For each item, the memo must address the taxpayer’s position, the examiner’s position, and the possible hazards of litigation.
- **Final Evaluation**: Includes a recap of the relevant factors, the weight assigned to each factor, and clearly illustrates the settlement recommendation and rationale.

**Appeals Conference**

- Proceedings in appeals conferences are informal. Testimony is not taken under oath, but there may be affidavits submitted or statements made in writing under penalties of perjury.
- For cases docketed in the Tax Court, the appeals conference is typically scheduled within 45 days of the date the case is transferred to Appeals.
- For cases not docketed in the Tax Court, although an appeals conference is customary, it is not required and the failure to grant a taxpayer’s request for a conference will not invalidate any Notice of Deficiency issued by Appeals. *Estate of Barrett v. Comm’r*, 68 TCM 1036 (1994), affirmed by *Estate of Barrett v. Comm’r*, 87 F.3d 1318 (9th Cir. 1996) (unpublished opinion).
- Requesting an appeals conference, and participating in one if it is granted, is mandatory for taxpayers who seek to recover fees and costs both at the IRS level and from the Tax Court. See 26 U.S.C. § 7430; Treas. Reg. 301.7430-2.
Alternative Dispute Resolution

- Fast Track Settlement
- Fast Track Mediation
- Mediation
- Arbitration

Fast Track Settlement is initiated while the case is still in Examination or Collections. Appeals personnel attempt to resolve disputes before the audit is completed. The program is available to large and mid-size businesses that currently have unagreed issues in at least one open year under examination. An Appeals Officer or an Appeals Team Case Leader acts in the role of mediator to help the parties resolve issues.

- Either the taxpayer or the examiner can request FTS by completing Form 5701 prior to issuance of the 30-day letter.
- The taxpayer can withdraw from FTS at any time.
- The taxpayer retains all appeal rights.

**Alternative Dispute Resolution – Fast Track Mediation**

Fast Track Mediation is available for cases that are in Small Business/Self-Employed Division of the IRS.

- Most cases are resolved within 40 days.
- No formal written protest or statement is required.
- FTM is optional and can be supplemental to other dispute resolution attempts. It does not eliminate or replace existing dispute resolution options, including the taxpayer's opportunity to request a conference with a manager or a hearing before Appeals.
- The taxpayer may withdraw from the FTM process at any time.
- Most cases not docketed in any court will qualify for FTM.


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**Alternative Dispute Resolution - Mediation**

- Mediation uses a third-party mediator to help the taxpayer and Appeals reach a negotiated settlement of the issues that remain unresolved following settlement discussions in Appeals.
- The IRS expects that the parties will complete the agreement to mediate within three weeks after being notified that Appeals approved the mediation request and proceed to mediation within 60 days after signing the agreement to mediate. A taxpayer's inability to adhere to these timeframes, without reasonable cause, may result in Appeals' withdrawal from the mediation process.
- The taxpayer and the Appeals Team Manager will select the mediator. The mediator must be an Appeals employee who is a trained mediator. The taxpayer may also elect to use a non-IRS co-mediator, at the taxpayer's expense, however, a non-IRS mediator cannot represent the taxpayer in any future proceedings that involve the issues or transaction that is the subject of the mediation.
**Alternative Dispute Resolution - Mediation**

- Each party must submit a discussion summary of the issues to the mediator, including the party's arguments in favor of the party's position, no later than two weeks prior to the mediation.

- Either party may withdraw from the mediation process any time before reaching a settlement of the issues being mediated by notifying the other party and the mediator in writing.

- At the end of the mediation process, the mediator must prepare a brief written report and submit a copy to each party. If the parties reach an agreement on all or some issues through the mediation process, Appeals closes the case, typically by issuing a closing agreement.

- If the parties do not reach an agreement on an issue being mediated, they may request arbitration for the issue, provided the mediation issue meets the requirements for arbitration. If arbitration is not requested or approved, Appeals will not reconsider the mediated issues and a deficiency notice is issued for all unagreed issues.

See Rev. Proc. 2002-44 for complete list of Mediation Procedures.

**Alternative Dispute Resolution – Arbitration**

- The Appeals arbitration program is available for certain cases within Appeals jurisdiction. Either the taxpayer or Appeals officer can request binding arbitration by making a written request. Both parties must agree to proceed with arbitration.

- Arbitration is available for **factual disputes only**. Arbitration is not available for legal issues, collection cases other than OIC or TFRP cases, frivolous claims, etc.

- Arbitration is **binding and final**. Neither party may appeal the decision of the arbitrator or contest the decision in any judicial proceeding.

- The taxpayer and Appeals, by mutual agreement, may select an arbitrator from Appeals, or from any local or national organization that provides a roster of “neutrals”.
Alternative Dispute Resolution – Arbitration

**Appeals Arbitrators**

If the parties select an Appeals arbitrator, the arbitrator must be from another Appeals office, or from the office of the Chief, Appeals. Appeals pays all expenses associated with an Appeals arbitrator.

**Neutral Arbitrators**

If the parties select a non-IRS Arbitrator, the parties share equally the compensation and other expenses of the arbitrator as well as any reasonable costs for the services of a non-IRS administrator.

Both the taxpayer and Appeals must prepare a summary of its position for consideration by the arbitrator at least 30 days prior to the scheduled arbitration session.

*Ex parte* communications between the arbitrator and either party are prohibited.

The parties may withdraw from the arbitration process to reach a final Appeals settlement at any time before the date of the arbitration session by mutual agreement.

The arbitrator must prepare a written report and submit a copy to the administrator 30 days after the session. Because the arbitrator is limited to the task of finding facts, the report will not provide any decision or reasoning that represents an interpretation of the law.

Once the Arbitrator renders a decision on all or some issues through the arbitration process, Appeals will close the case and prepare a specific matters closing agreement. If the settlement requires a refund in excess of $2 million, Appeals must report the settlement to the Joint Committee on Taxation.

Litigating

Faced with a notice of deficiency, the options are:

1. File a petition in the Tax Court for redetermination of the deficiency and do not pay the tax;

2. File a petition in the Tax Court for redetermination of the deficiency and deposit the tax due to stop interest from accruing;

3. Pay the tax due shown on the notice of deficiency, file a claim for refund with the IRS, and then file a suit for refund in U.S. District Court; or

4. Pay the tax due shown on the notice of deficiency, file a claim for refund with the IRS, and then file a suit for refund in the Court of Federal Claims.

<table>
<thead>
<tr>
<th>Tax Court</th>
<th>District Court</th>
<th>Court of Claims</th>
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<tr>
<td>Prepayment of tax is not required</td>
<td>Prepayment of tax is required</td>
<td>Prepayment of tax is required</td>
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<tr>
<td>Judges are traditionally tax experts</td>
<td>Judges are generalists</td>
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</tr>
<tr>
<td>Jury trial is not available</td>
<td>Jury trial is available</td>
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<tr>
<td>Tax Court Rules govern • Limited discovery • Stipulations required</td>
<td>Federal Rules of Civil Procedure govern • Formal discovery</td>
<td>Rules of the U.S. Court of Federal Claims • Formal discovery pursuant to FRCP</td>
</tr>
<tr>
<td>IRS Chief Counsel’s office litigates and has settlement authority. Appeals also retains SA for first 4 months after NOD issues (unless Appeals issued NOD).</td>
<td>DOJ Tax litigates and has settlement authority</td>
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<td>Taxpayer’s burden is to show erroneous assessment (not a requirement to establish correct tax)</td>
<td>In a refund action, taxpayer’s burden is to prove both entitlement to a refund and exact amount to which he is entitled</td>
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<td>Located in Washington, D.C. or throughout U.S.</td>
<td>Refund actions must be brought in the district where the taxpayer resides at the time the litigation is filed.</td>
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Claim for Refund

- The filing of a proper claim for refund or credit is a condition precedent to suit for recovery of taxes overpaid. Filing means delivery of IRS Form 843, Claim for Refund, to the proper Internal Revenue Service Center.

- Neither the District Court nor Court of Claims has jurisdiction to consider a claim for refund that was not first timely filed and rejected by the IRS. The theory of the case in the claim for refund filed with the IRS must not “substantially vary” from the theory presented to the District Court or Court of Claims.

Claim for Refund – Statute of Limitations

- A claim for refund must be made within three years of the date a return was filed or two years from the date the tax was paid, whichever is later.
  - Check all relevant state statute of limitations for filing claims for refund.

- A taxpayer can file a suit for a refund of taxes paid in either the Court of Claims or the United States District Court as soon as six months after the date that the refund claim is filed, or the date that the IRS renders a decision on the claim, whichever is earlier. The taxpayer can wait as long as two years until after a notice of disallowance is issued by the IRS to file suit.
Claim for Refund – Claims over $2 million

- The IRS may not make a refund or credit in excess of $2 million of any income, estate or gift taxes or of any tax imposed on public charities, private foundations, operators' trust funds, pension plans or real estate investment trusts until 30 days after it reports the refund or credit to the Congressional Joint Committee on Taxation. 26 U.S.C. § 6405(a), as amended by the Community Renewal Tax Relief Act of 2000, P.L. 106-554, Act §305 (December 21, 2000).

- In the event the JCT disagrees with or questions the position taken by the IRS, the refund is generally not processed pending the resolution of the dispute. However, the determination whether to issue or deny a refund or credit rests solely with IRS regardless of the JCT's favorable or unfavorable views on the proposed action. (IRS Chief Counsel Notice, CC-2003-023, July 8, 2003.)

Claim for Refund – Burden of Proof

- Unlike in a suit for redetermination of a deficiency in Tax Court, a taxpayer's burden in a claim for refund includes a burden to show both that the IRS's assessment is not correct and to prove the correct amount of tax.

- Where the taxpayer introduces credible evidence relevant to ascertaining the taxpayer's liability, the burden of proof in court proceedings may shift to the IRS if the taxpayer: (1) has complied with present-law substantiation requirements; (2) has complied with present-law recordkeeping requirements; (3) has cooperated with reasonable IRS requests for meetings, interviews, witnesses, documents, and information; and (4) if not an individual, qualifies under net worth limitations for awarding attorneys' fees (i.e., if a corporation, trust or partnership, its net worth does not exceed $7 million).
**Attorney’s Fees**

Applications for fees and costs can be filed pursuant to Tax Court Rule 231. To qualify for an award of reasonable administrative or litigation costs, against the United States, the party must have:

(a) substantially prevailed as to the amount in controversy or on the most significant issues;
(b) not unreasonably protracted the proceedings; and
(c) exhausted the administrative remedies available to it within the IRS.

Applications for fees and costs associated with non-litigated matters must be sent directly to the IRS within 91 days of receipt of the final determination of liability in favor of the taxpayer.


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**Thanks!**

The presenters extend their appreciation for the preparation of these materials to Guinevere Moore, an associate at Holland & Knight, who focuses her practice on tax controversy and tax litigation.