

## Steptoe & Johnson LLP

### Tax Procedure Outline – Audit to Litigation

This outline discusses tax controversy procedures, starting before the filing of the return, continuing through the IRS examination and Appeals stages, and up to the beginning of the litigation stage. The purpose of this outline is to identify and explain tax procedure requirements and opportunities. Knowledge and use of applicable tax procedure rules can be critically important to achieving the successful resolution of substantive tax issues. Tax controversy procedures create the danger of damaging pitfalls, as well as the opportunity to adopt creative and successful strategies.

The outline proceeds on a chronological basis, from the beginning through the end of the tax process. For each stage in the tax process, headings in the outline raise procedural questions, identify procedural risks, and describe procedural opportunities. This outline does not contain in depth analyses of the procedural rules, but does provide references to additional resources.

#### **When the Business Engages in a Tax Sensitive Transaction, What Document Retention Issues Should I Consider?**

- I. Stress to participants in the transaction that they are creating a written record.
  - A. Most business documents cannot be protected as confidential documents.
  - B. The attorney-client privilege protects only confidential communications between an attorney and a client in the course of their professional relationship. The work product doctrine protects only materials that contain an attorney's mental impressions, conclusions or analysis prepared in anticipation of or in the course of litigation. The application and scope of these protections is often disputed.
  - C. Participants in the transaction should avoid making communications that are based on factual or legal assumptions, that jump to legal conclusions, or that contain speculation not grounded on fact or considered legal analysis.
- II. Be sure to compile and maintain relevant information
  - A. Maintain documents that relate to the structure of the transaction, the conduct of the transaction, the business purpose for the transaction, and other relevant issues.
  - B. Document the identities of participants in the transaction, and memorialize critical facts and analyses.

- C. Remember to preserve hard copies of relevant emails and electronic files.
  - D. Maintain documents for time periods that are appropriate in light of the applicable statutes of limitation for the periods affected by the transaction.
- III. Once the relevant documents and information have been compiled, handle it in ways that maintain applicable privileges and protections.
- A. Both the attorney-client privilege and work product protection may be waived by voluntary disclosure.
  - B. Accordingly, care must be taken that confidential documents and information are properly maintained in protected files and not disseminated or made available to persons other than those who received the communications.
  - C. Even an inadvertent disclosure to a third person may waive the privilege or protection.
- IV. At all times, adopt and follow a consistent document retention policy.
- A. The purpose of a document retention policy is to manage, properly and legally, documents generated by the taxpayer. Many documents are important and relevant enough to be retained. On the other hand, if there is no business reason or legal obligation to retain a document, it can be properly destroyed, as a matter of practice, to reduce administrative costs.
  - B. The document retention policy should specify the types of documents to be retained, the manner in which they will be stored, and the length of time that they will be retained.
  - C. Documents should not be destroyed if a legal “matter” to which they relate is pending or threatened. Dire consequences can result if documents are improperly destroyed. Employees should be instructed to obtain advice when uncertainties arise.

**Can I Be Proactive And Resolve  
Tax Issues Before The Return Is Filed?**

- V. Some issues can be resolved under the IRS’s Pre-Filing Program
- A. Certain taxpayers can request a pre-filing examination of certain issues in a year for which a tax return is not yet due. Rev. Proc. 2001-22.
  - B. A Pre-Filing Agreement (PFA) can be used to resolve factual issues and issues involving the application of well-established legal principles to stipulated facts.

- C. Note: PFAs cannot be used to resolve uncertain legal issues. If the taxpayer wants comfort regarding a legal issue that is not well-settled, the taxpayer can request a private letter ruling. Rev. Proc. 2003-1.
- D. Issues resolved in a PFA are permanently and conclusively resolved for the year covered by the PFA.

### **Can I Avoid Tax Penalties By Disclosing Issues On The Tax Return?**

#### VI. Disclosure of Issues on the Tax Return

- A. If the taxpayer has a reasonable basis for the tax treatment of an item, and discloses the item on the return, accuracy-related penalties will not be imposed. Code § 6662(d)(2)(B); Treas. Reg. § 1.6662-4(e).
- B. Disclosures are made using Form 8275 or Form 8275-R (for positions contrary to Treasury regulations). Treas. Reg. § 1.6662-4(f).
- C. Note: If the item is attributable to a tax shelter, disclosure alone will not prevent the imposition of penalties, see ¶ VII, below.

### **Can And Should I Disclose Transactions That May Be a “Tax Shelter”?**

#### VII. “Tax Shelter” Disclosures

- A. Code Section 6011 may require a disclosure.
  - 1. Pursuant to Code Section 6011, the IRS has issued regulations that require the disclosure of certain types of transactions. Treas. Reg. § 1.6011-4. Successive versions of these regulations, applicable to different time periods, have been issued over the years.
  - 2. In February 2003, the IRS issued final regulations effective for “reportable transactions” occurring on or after January 1, 2003. The regulations require that taxpayers that participate, directly or indirectly, in a “reportable transaction” must file a disclosure statement with their tax return, and with the IRS Office of Tax Shelter Analysis, for each year that is affected by the reportable transaction.
  - 3. The regulations describe six classes of reportable transactions: listed transactions, confidential transactions, transactions with tax benefit loss protection, transactions generating significant losses, transactions with

significant book-tax differences, and transactions involving brief asset holding periods.

4. Disclosure must be made on Form 8886.
  5. If a taxpayer does not make a required disclosure, the taxpayer may not rely on an opinion or advice as a basis to establish a reasonable cause defense to the accuracy-related penalty under section 6662. Prop. Treas. Reg. 1.6664-4(c)(2).
- B. If the item is a “tax shelter,” merely disclosing the item will not avoid exposure to penalties. Code § 6662(d)(2)(C); Treas. Reg. § 1.6662-4(e)(2) and (g).
1. Penalties can be avoided by declining to claim the tax benefits associated with the item, and by avoiding the associated tax “underpayment.” The tax benefits could be claimed subsequently, in an amended return or by an affirmative claim asserted during the examination process.
  2. Penalties also can be avoided by filing a timely Qualified Amended Return (see ¶ VIII, below), but only if the taxpayer pays the tax and interest associated with the item. The payment of tax is treated as tax shown on the original return and eliminates the underpayment on which the penalty is based. Treas. Reg. § 1.6664-2(c)(2).
- C. When a tax shelter is involved, instead of being protected by mere disclosure, the taxpayer must be able to justify its position on the merits in order to avoid penalties (in situations where the tax benefits of the transaction were claimed on the original return).
1. Noncorporate taxpayers must have substantial authority and believe that their position is more likely than not correct. Code § 6662(d)(2)(C)(i); Treas. Reg. § 1.6662-4(g)(1).
  2. Corporate taxpayers must establish “reasonable cause” (substantial authority) and “good faith” (more likely than not correct) regarding their position. Code § 6664(c); Treas. Reg. § 1.6664-4(e).
- D. In prior years, the IRS developed a Disclosure Initiative, designed to promote the disclosure of tax shelter and other items, under which penalties could be avoided. IRS Announcement 2002-2; IRS News Release IR-2002-22 (Feb. 22, 2002).
1. The item had to be disclosed before the earlier of April 23, 2002, and the date on which the issue was raised by the IRS on examination. Thus, this disclosure initiative has now expired.
  2. Currently, the ability to participate in certain tax shelter settlement initiatives is limited to taxpayers that filed an Announcement 2002-2 disclosure statement. E.g., Rev. Proc. 2002-67, § 5.01.

- E. LMSB has developed an Abusive Tax Shelters Mandatory Information Document Request for examinations started after April 23, 2002, which seeks information regarding listed transactions.
- F. Note that Code section 6111 requires that “tax shelter organizers” register the “tax shelter” with the IRS. Purchasers of a registered tax shelter must disclose the shelter on Form 8271 attached to their return.
- G. Moreover, Code section 6112 requires any person that “organizes” or “sells” a “potentially abusive tax shelter” to maintain a list of investors in the shelter.

**Can I Disclose Issues To The IRS  
After The Tax Return Is Filed?**

VIII. Disclosure of Issues on Qualified Amended Returns

- A. Disclosures can be made on a qualified amended return. Treas. Reg. § 1.6664-2(c)(2).
- B. To be “qualified,” the amended return must be filed before IRS examination begins.

IX. “Audit File” Disclosures

- A. Large taxpayers are subject to the Coordinated Industry Case (CIC) Program (formerly Coordinated Examination Program (CEP)) and are audited for every year.
- B. Errors, affirmative issues, and other items can be disclosed by a CIC taxpayer to the IRS at the start of the examination. The disclosure statement is treated as a qualified amended return. Treas. Reg. § 1.6664-2(c)(4); Rev. Proc. 94-69.
- C. This disclosure procedure will not prevent imposition of penalties if the disclosed item is attributable to a tax shelter.

**How Does the IRS Routinely Conduct A  
Field Examination? Can I Control the Process?**

X. IRS Audit/Examination Procedures

- A. The IRS is authorized by statute to conduct examinations. Code § 7601. The time and the place of the examination must be “reasonable under the circumstances.” Code § 7605.

1. Revenue agents have broad examination powers, and it is difficult to limit the examination.
  2. In a chief counsel notice, the IRS has set forth its procedures applicable to requests for tax accrual and other financial audit workpapers. CC-2003-012.
  3. Taxpayers should ask the IRS for an audit plan and a time table.
  4. Taxpayers should seek to control what documents and information the agents obtain access to, and should keep track of what materials the agents have examined.
  5. Taxpayers should designate persons to whom the IRS can direct requests for information, and should ask that the IRS submit its requests for information in writing.
- B. CIC taxpayers have more formal examination procedures.
1. At the initial meeting, the taxpayer will meet the CIC examination team
    - a. In large cases, one revenue agent will be the case manager and will lead a team of agents. The case manager develops the audit plan and determines the scope of the audit.
    - b. One agent is the team coordinator. The taxpayer typically has most contact with this member of the audit team.
    - c. International, employee plan, or other special examiners may be brought in for special roles.
    - d. Outside consultants may be brought in.
  2. The taxpayer and the agents will discuss the audit plan.
    - a. The parties discuss office space and equipment to be provided to the agents, and the exam team's audit plan.
    - b. Timing and a completion date may be discussed.
- C. Large taxpayers also have the option of entering into a streamlined audit process called the Limited Issue Focused Examination (LIFE) process.
1. The purpose of the program is to focus the audit only on significant issues, making the audit process faster and less costly.
  2. Businesses with assets over \$10 million can opt into the LIFE process, which will be detailed in a Memorandum of Understanding (MOU) executed by the taxpayer and the IRS.

3. Under the agreement, the IRS agrees to limit the scope of its examination to certain identified issues. Also, the IRS agrees not to raise issues, and the taxpayer agrees not to assert affirmative claims, for issues under specified dollar thresholds.
4. The agreement also provides for exchanges of information, a time schedule for the audit, and other agreed upon procedures.

**How Much Time Does The IRS Have To Audit?  
Do I Have To Agree To An Extension of Time?**

XI. Time constraints – Limitations on Assessment and Collection

- A. Code § 6501 imposes a period of limitations on the IRS's ability to assess deficiencies. Tax deficiencies must be assessed within 3 years after the filing of the return. (Under Code § 6501(c) and (e), some special rules may apply, *e.g.*, in the case of fraud, substantial omissions, etc.)
- B. Code § 6501(c)(4) provides that the assessment period can be extended by agreement. Extensions of the assessment period are made using Form 872. (Special forms may be used in certain cases, *e.g.*, Form 872-F, 872-P, 872-S, etc.)
- C. A taxpayer can refuse to extend the assessment period. However, the IRS can protect itself by issuing a statutory notice of deficiency that asserts a blanket assessment.
- D. Taxpayers often extend the assessment period for relatively short time periods, so they can retain some control over timing.
- E. Alternatively, taxpayers can offer to extend the assessment period only with respect to particular issues.

**How Should I Respond To  
IRS Requests For Information?**

XII. Conduct of the audit and special examination procedures

- A. Revenue agents are authorized to examine books and records, and to examine persons. Code § 7602(a)(1). Agents ask for information using Form 4564, Information and Document Requests (IDRs).
- B. If the taxpayer fails to produce the required information or person, the IRS can issue an administrative summons. Code § 7602(a)(2).

- C. Care must be taken to read IRS information requests closely. If a request is ambiguous or incomplete, the taxpayer must consider whether it has options to comply narrowly or broadly, and must weigh the pluses and minuses of those options.
- D. Care must be taken when an IRS request for information encompasses information and documents that are privileged or protected.
  - 1. Disclosing the documents to the IRS can cause the permanent loss of an otherwise applicable privilege or protection.
    - a. Partially disclosing portions of a document can cause an implied waiver with respect to the entire document.
    - b. Likewise, providing a description of the substance of a document may cause an implied waiver with respect to the document.
  - 2. To preserve the privilege, a taxpayer can decline to disclose the privileged material, and instead submit a “privilege log” to the IRS.
    - a. The log should state which privilege or protection is being claimed, and describe the material in a manner that, without revealing the information, would enable the IRS to assess the applicability of the claimed privilege or protection.
- E. When the IRS has targeted several parties to a transaction, the parties can agree to a joint defense agreement. These agreements allow the parties to disclose to each other confidential materials related to matters of common interest without waiving a privilege or protection.
- F. Revenue agents can ask for information from third parties, and can issue a Third-Party Summons. Code § 7602-7604, 7609.
  - 1. When the agents seek information from third parties, they are required to notify, in advance, the taxpayer being examined. Code § 7602(c). The taxpayer can request to be present during the IRS’s contact with the third party. See Treas. Reg. § 301.7602-2.
  - 2. The taxpayer must be given notice of a third party summons. Code § 7609.

**Are There Special Examination Programs That May  
Influence How The Auditing Agents Handle My Exam?**

- XIII. The Agents may request Field Service Advice
- A. Revenue agents can ask for guidance with respect to particular issues from the IRS National Office by means of a Request for Field Service Advice (FSA).
  - B. Taxpayers may have no notice of the request. Also they have no right review the agent's request (although the agent may permit it), have no right to make a submission of their own, and have no right to a conference.
  - C. FSA's are not binding on Exam or Appeals.
- XIV. The Market Segment Specialization Program (MSSP)
- A. Agents with expertise in the segment will develop MSSP audit guides, which describe industry issues and audit techniques. The audit guide is not binding on the agent examining the taxpayer.
  - B. The agents auditing the taxpayer may be specialists in the taxpayer's segment.
- XV. Industry Specialist Program (ISP).
- A. The revenue agents will seek guidance regarding legal issues that are "coordinated" under the ISP program. IRM Exhibit 8.7.3-1 lists the ISP issues.
  - B. Certain specialized industries have Industry and Issue Specialists.
  - C. The Industry Specialists write position papers and advise examining agents regarding coordinated issues.
  - D. Examining agents must raise coordinated issues, contact the Industry Specialist, and make adjustments in accordance with the ISP position papers.
- XVI. TEFRA Partnership Provisions – Code § 6221-6234
- A. Partnership items reported on a taxpayer's return may be separately examined at the partnership level.
  - B. Special rules govern notification to partners, partner participation in the audit, assessments against partners, and judicial review of the proposed adjustments.
  - C. The tax matters partner (TMP) represents the partners as the contact person with the IRS.

**How Will I Be Notified that the Agents  
Are Asserting a Proposed Adjustment?**

- XVII. The revenue agents will assert issues by means of a Notice of Proposed Adjustment (a so-called NOPA)
- A. The notice is prepared on, and often referred to as, a Form 5701.
  - B. Taxpayers may indicate whether they agree or disagree with the proposed adjustment.

**Can I “Settle” Issues With the Examining Agents?**

- XVIII. Revenue agents have limited ability to settle issues.
- A. Typically, revenue agents do not have authority to settle legal issues based on hazards of litigation assessments.
  - B. On the other hand, revenue agents do have the ability to raise or not raise issues depending on legal interpretations and factual determinations. In practice, this ability effectively gives revenue agents some leeway to “settle” issues.
  - C. If an issue previously was settled by IRS Appeals, revenue agents are authorized to settle the issue in the examination on the same basis. Delegation Order 236.
  - D. If an issue is an ISP Coordinated issue, on which IRS Appeals has established written settlement guidelines, revenue agents are authorized to settle the issue in the examination according to the guidelines. Delegation Order 247.

**If the Revenue Agents Are Being Difficult,  
Are There Special Procedures That I Can Use To  
Get Issues Resolved At The Examination Level?**

- XIX. Requests for Technical Advice
- A. Either the taxpayer or the revenue agent can ask for guidance from the IRS National Office by means of a Request for Technical Advice. In response, the National Office will issue a Technical Advice Memorandum (TAM) or a Technical Expedited Advice Memorandum (TEAM). Rev. Proc. 2003-2; Rev. Proc. 2002-30.
  - B. If the revenue agents will not recognize that the position they are asserting is incorrect, the taxpayer can seek to request technical advice. When challenged, the

agents may drop the issue. Or, when the request is made, the National Office may reject their position.

- C. The taxpayer makes a written submission on the facts and applicable law, and will have a conference with the National Office.
  - D. The examining agents will follow the technical advice that they receive.
  - E. The IRS has provided for the issuance of expedited technical advice through the use of TEAMs. TEAMs allow the IRS to expedite the technical advice process by issuing guidance even when the revenue agent and the taxpayer disagree as to the facts. Any issue eligible for a TAM is also eligible for a TEAM.
- XX. The taxpayer and the revenue agents can seek to resolve certain audit issues under a Fast Track Dispute Resolution process. Notice 2001-67.
- A. The IRS established Fast Track Dispute Resolution as a pilot program, and accepted applications through November 14, 2002. The IRS made the program permanent on April 4, 2003. Internal Revenue News Release IR-2003-44.
  - B. The pilot program offers a Fast Track Mediation process or a Fast Track Settlement process.
  - C. In Fast Track Mediation, an Appeals Officer will act as a mediator to help the parties resolve factual issues. The mediation program has been unpopular, and was not made permanent.
  - D. In Fast Track Settlement, the Appeals Officer helps the parties resolve factual or legal issues and exercises Appeals settlement authority to effect the settlement. The settlement program is viewed as successful and, as mentioned above, was made permanent.
  - E. Issues must be fully developed, and the taxpayer must state its position in writing.
  - F. Agreements are reflected in closing agreements. If no agreement is reached, the issues can be protested to Appeals.
- XXI. Early Referral to IRS Appeals
- A. CIC taxpayers can ask Exam to refer developed, unagreed issues to Appeals, while the revenue agents continue to audit other issues. Code § 7123(a); Rev. Proc. 99-28.
  - B. Early referral can be a valuable tool to obtain the early resolution of “show stopper” issues.

- C. Exam may resist requests for early referral on the ground that the issue is not fully developed, or because the remaining issues will be completed before Appeals could resolve the early referral issue.
- D. ISP issues also can be referred to Appeals under the early referral program.
- E. Agreements with Appeals are reflected in closing agreements. Unagreed issues are returned to Exam and, if the case is protested, will not be subsequently reconsidered by Appeals.

XXII. In the examination of the tax years under audit, CIC taxpayers may enter into an Accelerated Issue Resolution (AIR) agreement with the IRS.

- A. Under the AIR agreement, the parties agree to apply the resolution of issues in the audit years to other affected tax years ending prior to the date of the AIR agreement. Rev. Proc. 94-67.
- B. While many issues can be the subject of an AIR agreement, Rev. Proc. 94-67 specifies a list of certain issues that cannot be addressed in an AIR agreement.
- C. The AIR agreement acts as a closing agreement for the issues addressed.

XXIII. The Industry Issue Resolution (IIR) program.

- A. This program was first announced as a time-limited pilot program, but then was made permanent. Notice 2000-65; Notice 2002-20; Rev. Proc. 2003-36.
- B. The IIR program provides a process to obtain IRS guidance to resolve frequently disputed tax issues that are common in various industries. Taxpayers, or industry groups, can suggest issues in need of resolution to the IRS, and can suggest possible options for resolving those issues. The goal is to obtain the resolution of issues that are the subject of repeated examinations affecting substantial numbers of taxpayers.
- C. The IRS will issue guidance, likely in the form of a revenue ruling or procedure, that permits taxpayers to adopt the recommended treatment.

**If the Issue Is not Settled, Will the  
Things I say Come Back to Haunt Me?**

XXIV. Federal Rule of Evidence 408 provides that offers in settlement, as well as statements and admissions of fact, that are made during settlement negotiations are not admissible in any subsequent litigation. *See Dow Chemical Co. & Subsidiaries v. United States*, 2003 WL 1701524 (E.D. Mich. Mar. 31, 2003).

## **What Will the Agents Do to Conclude the Examination Process?**

### XXV. Issuance of the 30-Day Letter and Revenue Agents' Report (RAR)

- A. Code § 6212 provides that the IRS is prevented from making an assessment until after it has issued a statutory notice of deficiency (statutory notice, stat notice, or 90-day letter).
- B. The agents usually do not end the examination process by issuing a 90-day letter. Normally, the agents will issue a 30-day letter, which transmits a RAR containing their proposed adjustments.
- C. The RAR contains all of the proposed adjustments (usually, copies of the NOPAs), and a recomputation of tax liability showing a proposed deficiency or overassessment.
- D. The letter transmitting the RAR is called the 30-day letter because it gives the taxpayer 30 days to submit a protest, which generally is necessary if the taxpayer wants the proposed adjustments to be considered by IRS Appeals.
  - 1. Protest procedures are discussed below.
- E. The issuance of the 30-day letter triggers the running of “hot interest” on large corporate underpayments. Code § 6621(c)(2).
  - 1. The taxpayer can make a payment to stop the running of interest.
  - 2. The taxpayer can make a deposit in the nature of a cash bond.

## **When I Receive a 30-Day Letter, What Options Do I Have?**

### XXVI. Three options available to conclude the examination process.

- A. Option #1 – Tentatively agree with the proposed deficiency.
  - 1. The taxpayer can execute a Form 870, which waives the restriction that prevents the IRS from making an immediate assessment.
  - 2. As a consequence, the taxpayer waives the right to receive a statutory notice of deficiency and thus forfeits the right to go to Tax Court.

3. The taxpayer does not waive the right to file a refund claim and to proceed to refund litigation.
- B. Option #2 – Fail to respond to the 30-day letter.
1. The IRS is prohibited from making an assessment, but will issue a statutory notice of deficiency.
  2. The taxpayer has the right, within 90 days of the statutory notice, to file a petition in the Tax Court. No assessment will be made and the taxpayer need not pay the proposed deficiency.
  3. The taxpayer can pay the asserted deficiency, and can file a refund claim.
- C. Option #3 – File a Protest.
1. Within the 30-day period following issuance of the 30-day letter, the taxpayer can file a protest with IRS Appeals.
  2. The taxpayer can request an extension of time to file the protest. The outer limit on extensions of time typically is 90 days.
  3. Large corporate taxpayers automatically are permitted a 90-day period to file the protest. Treas. Reg. § 601.105(d), 106; IRM, Handbook No. 4.3.11, § 16.4.

**Should I Dispute the Proposed Adjustments  
By Filing a Protest With IRS Appeals?**

XXVII. Filing a Protest and Going to IRS Appeals

- A. The decision to protest or not to protest
1. Why protest?
    - a. You obtain an additional opportunity to resolve issues. Appeals is able to settle issues on a hazards of litigation basis.
    - b. You keep your options to proceed to additional forums (see below) fully open.
    - c. You can delay payment of proposed tax increases.
    - d. You can learn more about IRS's position, and refine your arguments.

2. Why not protest?
  - a. You may not want the delay, if you want to litigate as soon as possible.
  - b. You may not want to give the IRS more time to develop its position.
  - c. You may not want the IRS to identify new issues.

### **What Are the Procedures for Filing a Protest?**

- B. Contents of the Protest
  1. The IRS specifies the required form and contents of the protest. Publication 5.
    - a. Taxpayers can file either a full or a skeletal protest.
    - b. Taxpayers can raise affirmative issues in the protest.
  2. The taxpayer must sign a verification, under penalties of perjury, of the facts set forth in the protest.
  3. The taxpayer's representative should attach a Form 2848, Power of Attorney.

### **Can the Revenue Agents Respond to My Protest? Can the Agents Talk to Appeals and "Poison the Well"?**

- C. The revenue agents will file a Rebuttal
  1. The revenue agents receive a copy of the protest, and will prepare a written rebuttal supporting their proposed adjustments.
  2. The agents comment on legal and factual issues raised by the taxpayer in the protest.
- D. Formerly, Appeals Officers would meet with the revenue agents, without the taxpayer, prior to the Appeals conference to discuss the protest and the rebuttal. Now, the IRS prohibits these discussions unless the taxpayer is given the opportunity to attend. See "Ex Parte Communications," below.

**Can Appeals Also Ask Me for  
Extensions of the Assessment Period?**

- E. Appeals also will ask for extensions of the period for assessment
  - 1. Extensions can be effected using Form 872.
  - 2. Extensions also can be made using Form 872-A, which are open ended extensions. Open-ended extensions are terminated using Form 872-T.

**What Are the Procedures for  
Conducting the Appeals Conference?**

- XXVIII. The Appeals Conference
  - A. Composition of the Appeals team
    - 1. Smaller cases may have a single Appeals Officer
    - 2. Larger cases will have an Appeals team, and the team will have a Team Chief, and Appeals Officers
  - B. Ex Parte Communications
    - 1. Appeals Officers are prohibited from having ex parte communications with other IRS employees to the extent those communications appear to compromise the independence of Appeals. Rev. Proc. 2000-43.
    - 2. Ex parte communications are communications between the Appeals Officer and any other IRS employee, without participation by the taxpayer, in which the merits of issues are discussed.
    - 3. If the Appeals Officer wants to discuss a case with the examining agent, the taxpayer must be offered the opportunity to participate.
  - C. Attendance at the conference
    - 1. Should taxpayer's in-house representatives attend?
    - 2. Expert consultants may attend.

## **What Settlement Authority Do the Appeals Officers Have?**

- D. Appeals' ability to settle issues
  - 1. Appeals is supposed to seek a "fair and impartial resolution" of the case.
  - 2. Appeals should apply a "hazards of litigation" standard in considering settlement of issues.
- E. Appeals' ability to raise "New issues"
  - 1. Appeals should not raise new issues unless the ground for opening the issue is a substantial one and the potential effect upon the tax liability is material. Treas. Reg. § 601.106(d)(1); IRM § 8.6.1.4.
  - 2. Appeals consideration is not a continuation of the examination. New issues should not be raised, or threatened to be raised, for bargaining purposes.
- F. Appeals can ask for a legal opinion from district counsel.

## **Can I Accelerate the Appeals Process?**

- G. Mutually Accelerated Appeals Process (MAAP).
  - 1. MAAP is an IRS initiative to reduce the time necessary to resolve cases in Appeals for CIC taxpayers by adding members to Appeals teams and/or creating new teams. Internal Revenue News Release IR-2000-42.
  - 2. Taxpayers can ask Appeals for a MAAP agreement.

## **Are There Procedures That Restrict Appeals Officers' Ability to Settle Cases?**

- H. Appeals Coordinated Issues (ACI)
  - 1. Certain issues have been designated ACIs, in order to obtain consistency in treatment. Appeals officers have restricted ability to settle ACI issues.
  - 2. IRM § 8.7.3.11. IRM Exhibit 8.7.3-2 lists the ACIs.

**If My Appeals Officers Are Being Difficult,  
Are There Special Procedures That I Can Use To  
Resolve Issues At The Appeals Level?**

I. Technical Advice Requests

1. The taxpayer or the Appeals officer can file a request for technical advice with the IRS National Office. Rev. Proc. 2003-2.
2. If the TAM or TEAM favors the taxpayer, Appeals will follow the TAM or TEAM.
3. If the TAM or TEAM favors the IRS, Appeals still is able to concede or settle the issue.

J. Appeals Mediation program. Code § 7123(b)(1).

1. Mediation is optional and non-binding. A neutral third party mediator, without authority to impose its decision, assists the parties in settlement negotiations. The IRS announced a pilot program for a limited test period (Announcements 2001-9 and 98-99) and then made the program permanent (Rev. Proc. 2002-44).
2. Factual issues, legal issues, ISP issues, and ACI issues are eligible for mediation.

K. Appeals Arbitration program. Code § 7123(b)(1).

1. Arbitration is optional and binding. An arbitrator imposes a binding resolution on the parties. The IRS announced a pilot program for a limited test period (Announcement 2000-4) and then extended the program through June 30, 2003 (Announcement 2002-60).
2. Arbitration is available only for factual issues.

**What Options Do I Have Regarding How I  
Close the Case Out of IRS Appeals?**

XXIX. Conclusion of the Appeals process.

- A. A resolution of issues that affects other years can be effected through a closing agreement. Code § 7121. Form 906.

- B. There are three major options for closing a case out of Appeals. The correct option to use depends on what subsequent course of action the taxpayer seeks to take.

**What Do I Do If I Want to Finally Resolve  
The Case By Settling All of The Issues?**

- C. Option #1 – Totally agreed case
1. Compute the deficiency or overassessment due based on the resolution of the issues, and reflect that amount on Form 870-AD.
  2. The Form 870-AD is a waiver of the IRS's restrictions on assessment. The IRS will assess the tax due and send the taxpayer a notice demanding payment.
  3. Under the doctrine of equitable estoppel, the Form 870-AD is intended to have binding effect on both parties.

**What Do I Do If I Want to Settle Some Issues,  
But Also Want to Take Other Issues into Refund Litigation?**

- D. Option #2 – Partially agreed case, with unagreed issues reserved for litigation in district court or the Court of Federal Claims
1. Compute the deficiency or overassessment due based on (i) resolving the settled issues as agreed, and (ii) resolving issues to be reserved for litigation in favor of the IRS.
  2. Execute Form 870-AD reflecting the resulting deficiency, reserving the right to file a refund claim with respect to reserved issues, and listing the issues reserved for litigation. IRM § 8.8.1.2.2 (“Settlement with Reservations”).
  3. The Form 870-AD is a waiver of the IRS's restrictions on assessment. The IRS will assess the tax due and send the taxpayer a notice demanding payment.
  4. The taxpayer must file a timely claim for refund based on the issues reserved for litigation. (see below)
  5. If the taxpayer fails to reserve an issue, the issue cannot be raised in the claim for refund.

6. If the government fails to reserve an issue, that issue cannot be raised, except as an offset in refund litigation. (see below)

**What Do I Do If I Want to Settle Some Issues,  
But Also Want to Take Other Issues into the Tax Court?**

- E. Option #3 – Partially agreed case, with unagreed issues left for litigation in the Tax Court
  1. Compute the deficiency or overassessment due based on (i) resolving the settled issues as agreed, and (ii) resolving issues not settled in favor of the taxpayer.
  2. Execute Form 870-AD reflecting the agreed deficiency, listing the issues that have been settled. IRM § 8.8.1.2.1 (“Partial Settlement”).
  3. The Form 870-AD is a waiver of the IRS’s restrictions on assessment. The IRS will assess the tax due and send the taxpayer a notice demanding payment.
  4. The IRS will issue a statutory notice of deficiency seeking the tax due with respect to the unagreed issues.
  5. All issues listed as settled in the Form 870-AD are resolved. All other issues (raised or not raised, known or not known) remain fully in dispute. The IRS can raise any unsettled issue in the Tax Court as a “new matter.” Tax Court Rule 142.
  6. Having received a statutory notice of deficiency, the taxpayer can litigate in the Tax Court. Alternatively, the taxpayer can choose to pay the deficiency asserted in the statutory notice and file a claim for refund.

**If I Have Chosen to Take Issues into Refund Litigation,  
What Procedural Steps Must I Take After Leaving Appeals,  
And How Quickly Must I Act in Order Not to Lose My Rights?**

XXX. Preparation for Refund Litigation

- A. The required first step is to file a Claim for Refund. Code § 7422.
- B. The refund claim must be filed within the statutory limitations period. Code § 6511.

1. If no Form 872 agreement extending the period of assessment has been executed, the claim must be filed within three years of the filing of the return (as extended).
  2. If a Form 872 agreement extending the period of assessment has been executed, the claim must be filed within 6 months following the expiration of the extended assessment period. See Form 872.
  3. Alternatively, a claim for refund can be filed within 2 years of the date a payment is made, but limited to the amount of that payment.
- C. Contents of the refund claim
1. The claim is filed using Form 1120X.
  2. Each issue must be adequately described in the refund claim. Enough information must be provided to describe adequately the issue to the IRS.

### **What Issues Can and Should I Raise in the Refund Claim?**

- D. In order for an issue to be raised in the refund claim, the taxpayer should have reserved the issue for litigation in the Form 870-AD.
- E. Under the Variance Doctrine, if an issue is not raised in the refund claim, that issue cannot be raised in subsequent tax litigation (the complaint cannot vary from the claim). Treas. Reg. § 301.6402-2(b).
1. Therefore, it is critical to raise in the refund claim all of the issues that you want to litigate.
- F. Taxpayers that fail to timely file a formal, written refund claim containing an issue that they want to litigate may be able to contend that they have made an Informal Claim for Refund. See, e.g., *Arch Eng'g Co., Inc. v. United States*, 783 F.2d 190, 192 (Fed. Cir. 1986) (the minimum requirements for an "informal" refund claim include a written request for sums paid for a particular tax year).

### **What Action Will the IRS Take Regarding the Refund Claim?**

- G. IRS action on the claim
1. The IRS may not act at all on the refund claim.

2. The taxpayer can file the refund claim accompanied by a request that the IRS immediately disallow the refund claim. IRS News Release IR-1600. Also, the taxpayer can contact its examining agents and ask for immediate disallowance.
3. The IRS may send the taxpayer a notice of proposed disallowance of the refund claim. The taxpayer can protest the proposed disallowance to IRS Appeals.
  - a. The IRS will enclose a Form 2297, asking the taxpayer to waive its right to receive a formal notice of disallowance. These forms pose a danger to taxpayers, because they start the limitations period for filing suit, usually at an ill-defined date.
4. The IRS will send a formal notice of claim disallowance. The notice must be sent by certified or registered mail. Code § 6532.

**Once the Refund Claim is Disallowed,  
How Long Do I Have to File the Refund Suit?**

- H. The statute of limitations for filing the refund litigation.
1. The refund suit must be filed within two years of the date of the formal notice of claim disallowance.
  2. If the taxpayer executed Form 2297, suit must be filed within two years of the date on which the IRS accepts that form.
  3. The statute of limitations for filing suit can be extended using Form 907, if the IRS agrees to execute that form.

**If the IRS Fails to Disallow the Refund Claim,  
Can I File A Refund Suit Anyway?**

- I. Ability to commence the refund litigation
1. The taxpayer cannot file suit until after the IRS denies the claim for refund.
  2. However, if the IRS has not acted on the claim within 6 months of its filing, the taxpayer is free to file suit.
  3. If the taxpayer executed Form 2297, the taxpayer must wait 6 months to file suit.

4. In order to accelerate the time for filing suit, the taxpayer can request that the IRS disallow the claim immediately. IRS News Release IR-1600.

**If I Have Chosen to Take Issues into the Tax Court,  
What Procedural Steps Must I Take After Leaving Appeals?**

XXXI. Preparation for Tax Court Litigation

- A. A petition must be filed with the Tax Court.
- B. A petition can be filed in the Tax Court only if the taxpayer has received a statutory notice of deficiency (the statutory notice sometimes is referred to as the taxpayer's "ticket to the Tax Court").
- C. The petition must be filed within 90 days of the date of the statutory notice. Code § 6213.
- D. T. C. Rule 34 describes the required form and contents of the petition.

**In Choosing Whether to Litigate in the Tax Court,  
District Court, or the Court of Federal Claims,  
What Are Some Important Issues that I Should Consider?**

XXXII. Choice of Litigation Forum Issues

- A. Should I litigate in the Tax Court?
  1. What is the applicable precedent in the Tax Court?
  2. The appeal will go to the Court of Appeals in the circuit in which the taxpayer resides or has its principal place of business. Therefore, you should also consider the applicable precedent in that circuit.
  3. Consider the background, experience and expertise of the Tax Court judges. Consider the "attitude" and approach that the judges have taken regarding various types of issues. Obviously, there is a great deal of tax law precedent in the Tax Court, which presents an expanded opportunity to "read the tea leaves."
  4. Consider the foregoing factors in light of the type of issues that your case presents, and the types of arguments you will be making. How well will your particular case "play" before the Tax Court "audience"?

5. Your opposing counsel will be an IRS attorney from IRS District Counsel's office.
6. The Tax Court's rules of procedure will apply.
  - a. The Tax Court has limited discovery procedures available for the parties.
  - b. In the Tax Court, the parties must stipulate to facts to the extent possible.

**I Have an Issue the IRS Did Not Identify During the Audit.  
In the Tax Court, What Can the IRS Do if It Spots the Issue?**

7. The IRS can raise new issues as "new matters." T.C. Rule 142.
  - a. The IRS has no restrictions on its ability to raise new issues in its answer to the taxpayer's petition, and no restrictions on its ability to recover the tax associated with those new issues.
  - b. For example, suppose the taxpayer raises one issue in its petition, and that issue involves \$100 of tax. If the IRS spots a new issue, involving (say) \$1000 of tax, it can raise that issue in its answer. If the taxpayer loses both issues, its tax liability is increased by \$1100. (Contrast this result with the different result reached in the refund context, below.)
  - c. On these "new matters," the IRS has the burden of proof. However, typically this provides only a minimal advantage to the taxpayer.

**Are There Important Aspects of  
Refund Litigation that I should Consider?**

B. Refund Litigation

1. A taxpayer has two options regarding refund litigation.
  - a. One option is to file suit in United States District Court. The taxpayer can file suit in the district in which it resides or has its principal place of business. There may be some flexibility regarding the district in which suit can be filed.

- b. The other option is to file in the United States Court of Federal Claims. This is a court with national jurisdiction, available to all taxpayers, wherever located.

### **Should I Bring My Refund Suit in District Court?**

#### 2. Litigation in District Court

- a. What is the applicable precedent in the district?
- b. Appeal from the district court will be to the Court of Appeals in which the district is located. Therefore, you should also consider the applicable precedent in that circuit.
- c. Typically, in contrast to the Tax Court, district court judges will not be tax specialists, but generalist judges who encounter tax issues only periodically. Not being tax specialists, the judges may have different attitudes or approaches to tax issues.
- d. In contrast to the Tax Court, because district courts hear far more types of cases than tax cases, there may be less tax law precedent to be considered that is relevant to your issue.
- e. Jury trials are permitted in district courts. Consider whether your case is one that you believe, or that the government likely will believe, is suited to be heard by a jury.
- f. Opposing counsel will be from one of the regional litigation sections of the Tax Division of the Justice Department.
- g. Federal Rules of Civil Procedure will apply.
- h. Discovery rules allow far more discovery than is permitted in the Tax Court.
- i. A trial subpoena can be issued only to witnesses within the district, or outside the district but within a 100 mile radius of the courtroom. Thus, distant witnesses can not be compelled to testify at the trial.

## **Should I Bring My Refund Suit In the Court of Federal Claims?**

3. Litigation in the Court of Federal Claims
  - a. What is the applicable precedent in the Court of Federal Claims?
  - b. All appeal from the court will be to the Court of Appeals for the Federal Circuit. Therefore, you should also consider the applicable precedent in that circuit.
  - c. Typically, Court of Federal Claims judges will not be tax specialists, but also will not be generalist judges. The judges hear tax cases, patent cases, and claims against the United States. Consider the background, experience and expertise of these judges, and consider the “attitude” and approach that they have taken regarding various types of issues.
  - d. No jury trials are permitted.
  - e. Opposing counsel from the Court of Federal Claims section of the Tax Division of the Justice Department.
  - f. The Rules of the Court of Federal Claims apply. These rules differ from, but are similar to, the Federal Rules of Civil Procedure.
  - g. On a showing of good cause, the court can issue a trial subpoena to a witness that is outside the 100-mile radius of the place of trial.

### **I Have an Issue the IRS Did Not Identify During the Audit. In a Refund Suit, What Can the IRS Do if It Spots the Issue?**

- C. In refund litigation, the government can raise new issues only as “offsets.”
  1. The government has no restrictions on its ability to raise new issues in its answer to the taxpayer’s complaint.
  2. However, there is a significant restriction on its ability to recover the tax associated with those new issues. The government cannot affirmatively collect the tax related to the “offset” issue, but can only use “offset” issue to reduce the amount of a recovery that the taxpayer otherwise would be entitled to.
  3. For example, suppose the taxpayer raises one issue in its complaint, and that issue involves \$100 of tax. If the government spots a new issue,

involving (say) \$1000 of tax, it can raise that issue as an offset in its answer. If the taxpayer wins its issue, but loses the offset issue, it recovers zero, since its \$100 issue is “offset” by the issue that the government raised. However, the government is not able to collect the remaining \$900 related to the offset issue. The “offset” issue can only reduce the amount that the taxpayer otherwise would be entitled to recover. (Contrast this result with the different result reached in the Tax Court context, above.)

4. On these offset, the taxpayer has the burden of proof.

**Litigation Entails Different Sets of Procedural Rules,  
Poses Additional Dangers of Damaging Pitfalls, and  
Presents Different Opportunities for Creative and Successful Strategies.  
At the Pre-Litigation Stage, Taxpayers Should Keep Litigation Considerations In Mind.**

As taxpayers progress through the pre-litigation, tax controversy stage, they should have in mind their ultimate goal, and whether they expect that litigation may be necessary to achieve that goal.

Is the issue under examination one the taxpayer wants to settle, and keep out of litigation? If so, the taxpayer may develop and present the case aggressively at the administrative stage, and take advantage of the full range of procedural options described above.

Or, is the issue one that the taxpayer expects will be litigated? If so, the taxpayer may resist development of the issue at the administrative stage, and decline to fully expound its theories and arguments. In such a case, taxpayers that aggressively pursue the issue at the administrative stage may prematurely “tip their hand” and undermine their litigation posture. Thus, the ultimate litigation strategy should be considered even at the pre-litigation stage.

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