



## **Tax Procedure Outline: Audit to Litigation**

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Step toe's experienced tax controversy litigators include several who have served as Justice Department trial and appellate attorneys, judicial law clerks, and Treasury and IRS officials.

Our practice combines trial-tested litigation skills with up-to-date substantive tax experience, enabling us to take on the most challenging cases and achieve outstanding results for our clients.

Brief biographies of Steptoe attorneys who practice in the area of tax litigation, audit, and controversy are located immediately following the conclusion of the procedural outline, beginning on page 37.

# **Tax Procedure Outline – Audit to Litigation**

In this outline, we discuss 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 the 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. The taxpayer must stress to participants in the transaction that they are creating a written record.
  - A. Most business documents (paper and electronic) 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 Code §7525 privilege protects communications between a “federally authorized tax practitioner” and a client. 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 are often disputed.
  - C. Participants in the transaction should avoid making written 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.
  - D. Ill-considered statements in documents and emails may serve as an audit roadmap for the IRS and observations regarding the merits of issues may undermine IRS settlement negotiations and subsequent litigation.

- II. Be sure to compile and maintain all information and documents relevant to the transaction.
  - 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 (so-called electronically stored information or ESI). Also preserve emails and electronic documents in separate and easily retrievable electronic files. If a key team member leaves, make sure you will have access to those electronic files and emails. Find out how long your system retains emails in files before dumping them in a mass archive. You may want to collect and separately preserve emails to avoid the need for wide-ranging electronic record searches years later.
  - D. Maintain documents for time periods that are appropriate in light of the applicable statutes of limitation for the periods affected by the transaction.
  - E. When controversy looms, taxpayers should institute a “litigation hold,” which reminds record keepers to maintain and not destroy relevant documents.
    - 1. Failure to institute a “litigation hold,” with the result that documents are destroyed, may lead to a charge of “spoliation” (see next section, below).
    - 2. Failure to institute a “litigation hold” will undermine a claim that documents subsequently drafted were prepared “in anticipation of litigation” and are protected under the work product doctrine. In other words, if a taxpayer anticipated litigation it should have instituted a litigation hold.
    - 3. The taxpayer must have established policies for when to initiate a litigation hold, for ensuring that the scope of the hold is sufficiently broad, and for ensuring that documents are correctly retained.
- III. At all times, act consistently with an established 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 and routine, 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 (paper and electronic) should not be destroyed if a legal “matter” to which they relate is reasonably foreseeable, pending or threatened. Dire consequences can result if documents are improperly destroyed. Employees

should be instructed to obtain legal advice when uncertainties arise. Improper destruction or alteration of documents is called “spoliation,” and can lead to the imposition of sanctions, the drawing of adverse evidentiary inferences, and even the dismissal of a case in litigation. Spoliation is serious and can doom a case to failure from the start.

- D. If documents are to be destroyed, ensure that established document retention policies are followed.
- IV. 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 the 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 to whom the communications are addressed.
  - C. Even an inadvertent disclosure to a third person may waive the privilege or protection.
  - D. A waiver can occur not only for the disclosed document, but for all documents that address the same “subject matter.”

### **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 Agreement Program.
- A. 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. However, note that the cost is \$50,000 per issue. Rev. Proc. 2009-14, § 3.03 and 3.08.
  - B. 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. 2012-1.
  - C. Under the original PFA program, certain taxpayers could request a pre-filing examination of certain issues in a year for which a tax return was not yet due. Rev. Proc. 2001-22. On December 22, 2004, the program was expanded so that a taxpayer can request such an examination and agreement for up to four years beyond the current tax year. Rev. Proc. 2005-12. The program was made permanent in 2009. Rev. Proc. 2009-14. Internal Revenue Manual section 4.30.1 discusses the PFA procedures.
  - D. Issues resolved in a PFA are permanently and conclusively resolved by means of a closing agreement for the year(s) covered by the PFA. If the PFA resolves an issue for future years, a non-statutory PFA is executed. Rev. Proc. 2009-14, § 7.

- E. The IRS website ([www.irs.gov](http://www.irs.gov)) lists issues successfully completed in the program. (<http://www.irs.gov/businesses/article/0,,id=102667,00.html>)

### **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, the item is not attributable to a tax shelter, and the taxpayer adequately discloses the item on the return, accuracy-related penalties could be avoided. Code § 6662(d)(2)(B)(ii); Rev. Proc. 2012-15 § 3.03.
- B. Disclosures are made using Form 8275 or Form 8275-R (for positions contrary to Treasury regulations). Treas. Reg. § 1.6662-4(f).
- C. Disclosure on Form 1120 Schedule UTP satisfies the disclosure requirement; a separate Form 8275 or Form 8275-R need not be filed. Rev. Proc. 2012-15 § 3.07; Instructions for IRS Form 1120 Schedule UTP (2010).
1. Taxpayers are required to file Form 1120 Schedule UTP and disclose their uncertain tax positions. Treas. Reg. § 1.6012-2(a)(4).
  2. Form 1120 Schedule UTP requires a concise description of each uncertain tax position for which the taxpayer or a related entity has recorded a reserve in its financial statements, each uncertain tax position that the taxpayer expects to litigate, and the maximum amount of potential federal tax liability attributable to each uncertain tax position. For 2012, Form 1120 Schedule UTP is not required for corporations that have assets below \$50 million. In 2014 the threshold declines to \$10 million. Instructions for IRS Form 1120 Schedule UTP (2010).
- D. 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 “reportable transactions.” Treas. Reg. § 1.6011-4. Successive versions of these regulations, applicable to different time periods, have been issued over the years.
  2. The regulations require taxpayers that participate, directly or indirectly, in a “reportable transaction” to 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. Treas. Reg. 1.6011-4(a), (d) and (e).

3. The regulations describe five classes of reportable transactions: listed transactions, confidential transactions, transactions with contractual protection, transactions generating significant losses, and transactions of interest. Proposed regulations would add a sixth class, patented transactions. Treas. Reg. § 1.6011(b).
  4. Disclosure must be made on Form 8886. Currently, disclosure on Form 1120 Schedule UTP does not satisfy the disclosure requirement. Rev. Proc. 2012-15 § 3.07; IRS Announcement 2010-75. Taxpayers will need to disclose tax shelters resulting in tax reserves on the Schedule UTP form.
  5. Disclosures must be made for transactions that subsequently are identified by the Service as a listed transaction or a transaction of interest. Treas. Reg. § 1.6011-4(e)(2).
  6. If a taxpayer does not make a required disclosure, such failure by the taxpayer will be treated as strong evidence that the taxpayer did not act in good faith with respect to the portion of any underpayment attributable to the transaction. Treas. Reg. § 1.6664-4(d). Thus, a taxpayer who fails to disclose a reportable transaction is unlikely to prevail in asserting the reasonable cause defense to the accuracy-related penalty.
- B. Code Section 6662A imposes a 20 percent accuracy-related penalty on “reportable transaction understatements.” For purposes of Code Section 6662A, a “reportable transaction” is (1) a listed transaction, or (2) a reportable transaction, if a significant purpose of the transaction is the avoidance or evasion of Federal income tax. The penalty is increased to 30 percent if the transaction is not properly disclosed by the taxpayer.
- C. Code Section 6707A imposes a penalty on taxpayers who fail to file required disclosures with respect to a reportable transaction. The amount of the penalty is 75 percent of the decrease in tax shown on the return as a result of the transaction, or the decrease in tax that would have resulted from the transaction if it were respected for Federal tax purposes. The penalty is subject to a minimum amount of \$5,000 for individuals and \$10,000 for corporations. The maximum penalty for failure to disclose a listed transaction is \$100,000 for individuals and \$200,000 for corporations; the maximum penalty for failure to disclose any other reportable transaction is \$10,000 for individuals and \$50,000 for corporations. Note that the Code Section 6707A penalty can be imposed in addition to the Code Section 6662 or the Code Section 6662A accuracy-related penalty. This penalty can be imposed regardless of whether the reportable transaction causes an understatement of tax.
- D. If the item is a “tax shelter,” disclosing the item on the return will not automatically avoid exposure to accuracy-related penalties. Code § 6662(d)(2)(C).

1. Penalties can be avoided by declining to claim the tax benefits associated with the item, thus 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. Code §6662(d)(2)(A).
  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).
- E. A 20 percent accuracy-related penalty applies for understatements with respect to reportable transactions. Code § 6662A. Failure to disclose the transaction increases the penalty to 30 percent. Code §6662A(c).
- F. For transactions entered into after March 30, 2010, a strict liability 20 percent penalty applies for nondisclosed noneconomic substance transactions. Code § 6662(b)(6). Failure to disclose increases the penalty to 40 percent. Code §6662(i)(1).
- G. Code § 6111 requires each “material advisor” with respect to a “reportable transaction” (as defined in Code § 6707A(c)) to file a return describing the transaction and the potential tax benefits expected to result from the transaction. If a material advisor fails to file a return required under Code § 6111, a penalty of \$50,000 will be imposed for such failure. Code § 6707. In the case of listed transactions, the penalty is increased to the greater of \$200,000 or 50 percent of the gross income derived by the material advisor with respect to the aid, assistance, or advice provided with respect to the transaction.
- H. Moreover, Code § 6112 requires each material advisor with respect to a “reportable transaction” (as defined in Code Section 6707A(c)) to maintain a list of investors in such transaction. If a material advisor who is required by Code § 6112 to maintain an investor list fails to make the list available to the IRS in a timely manner, the advisor will incur a penalty equal to \$10,000 per day after an initial 20-day period, unless reasonable cause exists. Code § 6708.

### **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. Amounts of tax reported on a qualified amended return will be treated as if they had been reported on the original return for purposes of computing the amount of the tax “underpayment,” unless the original return reported a fraudulent position. Treas. Reg. § 1.6664-2(c)(2).

- C. To be “qualified,” the amended return must be filed before: (1) the date the taxpayer is first contacted concerning an IRS examination; (2) in the case of a promoted transaction, the date the tax shelter promoter is first contacted concerning an IRS examination; (3) in the case of a pass-through item, the date the pass-through entity is first contacted concerning an IRS examination; and (4) the date a John Doe summons is served on a third party with respect to an activity of the taxpayer for which the taxpayer claimed a tax benefit, and (5) the date on which the Service announces a settlement initiative for a listed transaction. Treas. Reg. § 1.6664-2(c)(3)(i).
- D. If a taxpayer fails to disclose a listed transaction for which a tax benefit is claimed, an amended return will be treated as a “qualified” amended return only if it is filed before: (1) the dates described above for qualified amended returns in general; (2) the date the IRS first contacts a person regarding an examination of that person’s liability for penalties under Code § 6707(a) with respect to the undisclosed listed transaction of the taxpayer; and (3) the date on which the Service requests from a taxpayer’s material advisor (or any person who made a tax statement for the benefit of the taxpayer) the information required to be included in a list under Code Section 6112 relating to a transaction that is the same as, or substantially similar to, the undisclosed listed transaction. Treas. Reg. § 1.6664-2(c)(3)(ii).

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.
  - 1. This disclosure procedure will not prevent imposition of penalties if the disclosed item is attributable to a tax shelter.
  - 2. Disclosure of issues up front may help to create a better relationship with Exam.

**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 IRS’s power to examine taxpayers is broad and difficult to limit.
  - 1. Certain limits are imposed, such as the requirement that the time and place of the examination be reasonable under the circumstances and that

the taxpayer not be subject to unnecessary examinations or multiple examinations for each taxable year. IRC 7605(a) and (b).

2. Otherwise, the examination may seek any information that “may be relevant or material.” Code § 7602(a) The IRS’s ability to examine tax returns and collect information is largely unfettered and difficult to limit.

B. The IRS’s examination power extends to tax accrual workpapers. See I.R.M. § 4.10.20 (“Requesting Audit, Tax Accrual, or Tax Reconciliation Workpapers”).

1. Tax accrual workpapers are audit workpapers that relate to the tax reserve for current, deferred and potential or contingent tax liabilities, however classified or reported on audited financial statements, and to footnotes disclosing those tax reserves on audited financial statements. These workpapers reflect an estimate of a company's tax liabilities and may also be referred to as the tax pool analysis, tax liability contingency analysis, tax cushion analysis, or tax contingency reserve analysis. I.R.M. § 4.10.20.2(2).
2. Taxpayers have claimed that tax accrual workpapers are entitled to attorney-client privilege and work product protection with mixed success. *Textron Inc. & Subs v. United States*, 577 F.3d 21 (1st Cir. 2009). *But see Deloitte, LLP v. United States*, 610 F.3d 138 (D.C. Cir. 2010).
3. The IRS states that it generally will not request tax accrual workpapers, absent unusual circumstances. A request will be made when the examiner identifies a specific issue and needs additional facts, the examiner has sought facts regarding the issue from the taxpayer and third parties, and the examiner has sought a supplementary analysis of facts relating to the issue. I.R.M. § 4.10.20.3.
4. If the taxpayer has engaged in a listed transaction and disclosed that transaction, the IRS will request only the portion of the tax accrual workpapers that concerns that transaction. I.R.M. § 4.10.20.3.2.3.
5. If the taxpayer did not disclose its listed transaction, or engaged in multiple listed transactions, the IRS will request all tax accrual workpapers. *Id.*

C. Taxpayers should ask the IRS for an audit plan and a timetable.

1. Taxpayers should seek to negotiate the scope and timing of the audit.
2. 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. Taxpayers should document all meetings in order to ensure a record of information provided orally and IRS positions or representations.
3. 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 (by submitting Information Document Requests, or “IDRs”).

D. CIC taxpayers have more formal examination procedures.

1. CIC taxpayers are in LB&I’s Quality Examination Process (QEP). As of 2010, QEP replaces the former Joint Audit Planning Process set forth in I.R.M. § 4.46, and that portion of the Manual is being updated. In the meantime, the IRS has issued a QEP Reference Guide (10/2010).
2. At the initial audit meeting, the taxpayer will meet the CIC examination team. I.R.M. § 4.46.5.
  - a. The taxpayer will identify the individuals to be contact points during the audit.
  - b. 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.
  - c. One agent is the team coordinator. The taxpayer typically has most contact with this member of the audit team.
  - d. International, employee plan, financial product, employment tax, excise, actuaries, or other special examiners may be brought in for special roles.
  - e. Outside consultants may be brought in.
3. The taxpayer and the agents will discuss the audit plan and agree on how the audit will be conducted.
  - a. The parties discuss office space and equipment to be provided to the agents, and the exam team’s audit plan.
  - b. The parties will normally discuss procedures for IDRs and other communications, timing for IDR responses, procedures for extensions and late IDR responses, procedures for proposed adjustments, and similar items.
  - c. Some ideas for the audit agreement: advance discussion of issues, receiving draft IDRs, black-out periods, use of presentations in lieu of IDR responses, and discussion of IRS risk analyses.
4. The QEP Reference Guide is on the IRS website at <http://www.irs.gov/businesses/article/0,,id=224139,00.html>.

E. Large taxpayers also have the option of entering into a streamlined audit process called the Limited Issue Focused Examination (LIFE) process. I.R.M. § 4.46.3.4.

1. The purpose of the program is to focus the audit only on significant issues, making the audit process faster and less costly.
2. The LIFE process 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.
  5. Formal LIFE examinations are becoming less common, but informal use of a materiality threshold for raising issues is increasing on an informal basis.
- F. Under the Compliance Assurance Process (CAP) program the IRS agrees to examine the taxpayer's transactions and material items prior to the filing of the tax return. I.R.M. § 4.60.1-3.
1. The goals of the CAP program are currency, transparency and cooperation. The benefit to taxpayers is that material items can be resolved before the return is filed.
  2. If issues are agreed, they are memorialized in a closing agreement. Fast track settlement is available to resolve issues.
  3. CAP goes through three phases: 1) pre-CAP audit of filed tax returns, 2) a CAP audit prior to filing the current return, and 3) compliance and maintenance in accordance with a CAP Memorandum of Understanding (MOU).
  4. If a taxpayer does not adhere to the terms of the MOU, CAP can be terminated. A taxpayer may terminate CAP at any time.
  5. As of 2012, the IRS is seeking to expand the CAP program.

**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 Section 6501 imposes a period of limitations on the IRS's ability to assess deficiencies. Tax deficiencies must be assessed within three years after the filing of the return. (Under Code Section 6501(c) and (e), some special rules may apply, *e.g.*, in the case of fraud, substantial omissions, etc.)
  - B. Code Section 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. I.R.M. § 4.9.8.3. In most instances failing to extend is an unattractive option.

- D. Taxpayers often extend the assessment period for relatively short time periods, so they can retain some control over timing. The Service generally will not let the assessment period get within six months of its expiration date.
- E. Alternatively, taxpayers can offer to extend the assessment period only with respect to particular issues, by means of a restricted consent. This can be effective at the end of the audit process, when the IRS has narrowed down the scope of the examination. Taxpayers must be careful to avoid cutting off the statute of limitations for making affirmative claims. I.R.M. § 25.6.2.8.

### **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 §§ 7601 and 7602(a)(1). Agents ask for information using Form 4564, Information and Document Requests (IDRs). I.R.M. § 4.46.4.4.
- B. If the IRS seeks foreign-based documentation, it can make a formal document request. Code § 982.
- C. If the taxpayer fails to produce the required information or person, the IRS can issue an administrative summons. Code § 7602(a)(2).
- D. 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.
- E. Many IRS agents will negotiate the scope of IDRs. To allow this to happen, taxpayers should ask to review draft IDRs. When the taxpayer believes that an IDR is overly broad, the IRS will usually discuss how it can obtain the information it needs with a narrower request. This is one of many areas where a good working relationship with the examiners will produce substantial benefits for both the IRS and the taxpayer.
- F. 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.
    - c. Disclosing a document also could cause a subject matter waiver of privilege on all documents that address the same subject.

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 or a court to assess the applicability of the claimed privilege or protection.
  3. Taxpayers may redact certain information relating to preparation of Form 1120 Schedule UTP from tax reconciliation workpapers, including (i) working drafts, revisions, or comments concerning the concise description of tax positions reported on Schedule UTP, (ii) the amount of any reserve related to a tax position reported on Schedule UTP, and (iii) computations determining the ranking of tax positions to be reported on Schedule UTP or the designation of a tax position as a Major Tax Position. IRS Announcement 2010-76. This rule applies to requests outstanding on or made after September 24, 2010, in any open examination.
- G. The IRS can request to interview employees. Often, the IRS will accept written responses in lieu of an employee interview. This permits the taxpayer to provide a more considered response. If the IRS insists on an interview, great care should be exercised.
1. The person to be interviewed, the scope of the interview, and the topics to be addressed should be negotiated. The questions to be posed should be requested in advance of the interview.
  2. The IRS may record the interview. Alternatively, the examining agents may simply take notes. Testimony can be taken under oath. Code § 7602(a)(2).
  3. Statements made (or not made) by the interviewee become a “prior statement” of that person. Subsequently, they will be available as evidence, and can be used to impeach that person in later proceedings. Thus, these interviews can be critically important. Because these interviews occur early in the process, when issues may not have been fully developed or formulated, there is a great risk that the testimony will later prove to be damaging.
  4. Sometimes taxpayers may volunteer employee interviews as a way to reduce the scope of IDRs or move issues forward. The selection and preparation of employees to be interviewed is critical to their success.
- H. When the IRS has targeted several parties to a transaction, the parties can agree to a joint defense or common interest 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.
1. While these agreements can be beneficial, they also pose risks, and counsel should carefully consider those risks.

- I. Revenue agents can ask for information from third parties, and can issue a Third-Party Summons. Code § 7602-7604, 7609.
1. When the agents intend to seek information from third parties, they are required to notify, in advance, the taxpayer being examined. Code § 7602(c)(1).
  2. The IRS should periodically inform the taxpayer of what third parties have been contacted, and the taxpayer can request such a list. Code § 7602(c)(2).
  3. Taxpayers do not have an automatic right to be present when third parties are interviewed. Nevertheless, the third party can request that the taxpayer be present during the IRS's contact with the third party. See Treas. Reg. § 301.7602-2; I.R.M. § 25.5.5.4.8.
  4. It behooves a taxpayer to be on good terms with third parties with relevant information and to give them advance notice that they may be contacted by the IRS. The taxpayer must rely on the willingness of the third party to tell the IRS that they would like the taxpayer to be present at the interview.
  5. The taxpayer also must be given notice of a third party summons. Code § 7609. The date for responding to the summons must be 24 days after notice to the taxpayer, so that the taxpayer will have an opportunity to object to the summons. Code § 7609(a)(1). The taxpayer can initiate a district court proceeding to quash the summons. Code § 7609(b).

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

XIII. The Agents may Request Legal Advice

- A. Revenue agents can ask for guidance with respect to particular issues from Chief Counsel Field attorneys and from the IRS National Office. This advice is an alternative to Technical Advice Requests, which are requested by the taxpayer and the examination team, discussed below at XX.
- B. Technical Advice is preferred by the IRS when the advice is intended to establish the position of the IRS and when they deem it advisable for the taxpayer to participate in the process.
- C. Field Counsel provides legal advice when matters can be resolved with a high degree of certainty based on settled law. Associate Chief Counsel must be involved when the issues considered are novel and significant. I.R.M. § 33.1.1.2.
- D. When an agent requests Legal Advice, taxpayers may have no notice of the request. Also they have no right to 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. This is another area where a good relationship with the

examiners can pay off. Both parties to the examination benefit when they share legal reasoning and can narrow issues.

- E. Field Advice is not binding on Exam or Appeals. As a practical matter, however, agents almost never disregard Field Advice. Bad counsel advice secured without taxpayer consultation can drastically limit a taxpayer's ability to properly resolve an audit.

#### XIV. Issue Tiering – Industry Issue Focus (and Issue Practice Groups)

- A. The agent may seek guidance regarding compliance issues that have been identified by LB&I as high-risk tax issues. Issue Management Teams (IMTs) research and develop fact patterns associated with specific tiered issues and develop resolution strategies.
- B. The issues are prioritized based on prevalence and compliance risk.
  - 1. Tier I- High Strategic Importance: These issues pose the highest compliance risk across multiple LB&I Industries and generally include large numbers of taxpayers, significant dollar risk, substantial compliance risk, or are high visibility.
  - 2. Tier II- Significant Compliance Risk: These issues have potentially high non-compliance risk, or significant compliance risk to a particular industry. This tier includes emerging issues for which there is established law, but LB&I's position requires development.
  - 3. Tier III- Industry Risk: These issues have the highest compliance risk for a particular industry and require unique, industry-specific treatment.
- C. When an exam team identifies that a taxpayer has a tiered issue, an attorney is assigned by Division Counsel to work with the team on the case. The issue may well be out of the control of the exam team. Also, issues with factual differences may nevertheless get treated in the same manner if the IRS takes a "one size fits all" approach.
- D. See I.R.M. § 4.51.5, "Industry Focus and Control of LMSB Compliance Issues"; I.R.M. § 4.51.6, "Issue Management Process Guide"; and the listing of tiered issues at <http://www.irs.gov/businesses/corporations/article/0,,id=200567,00.html>.
- E. In 2011-2012, the IRS announced that it would phase out the IIF tiering process and shift its coordination efforts to an Issue Practice Groups (IPG) approach.
  - 1. Tiering is thought to be too restrictive, inflexible and controlling.
  - 2. This approach will deploy and allocate subject matter experts, technical advisors and IRS counsel personnel in a collaborative manner to develop various issues. The approach is intended to be decentralizes, more flexible, and more informal.

- XV. The Market Segment Specialization Program (MSSP)
- A. Agents with expertise in the segment will develop MSSP Audit Technique 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.
  - C. See the listing of Audit Technique Guides at <http://www.irs.gov/businesses/small/article/0,,id=108149,00.html>.
- XVI. Compliance Coordinated Issues (CCI) (formerly the Industry Specialization Program)
- A. The revenue agents will seek guidance regarding legal issues that are "coordinated" issues.
  - B. Certain specialized industries have Industry and Issue Specialists, also known as "Technical Advisors" or "TAs," and Industry Counsel.
  - C. The Industry Specialists and Counsel write position papers, Coordinated Issue Papers (CIPs), 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 CIP position papers.
  - E. See the listing of CIPs at <http://www.irs.gov/businesses/article/0,,id=96445,00.html>.
  - F. TAs are especially important in the insurance industry, due to its highly specialized nature. Agents will frequently consult with the relevant TAs on insurance issues. Since the TAs spearhead the development of new issues, both taxpayers and agents are well advised to gain as much information as possible about issues that the TAs are focused on.
- XVII. 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. Treas. Reg. § 301.6223(g)-1.

## **How Will I be Notified That the Agents Are Asserting a Proposed Adjustment?**

XVIII. 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. The Form 5701 serves as the building block for the revenue agent’s report (RAR), and therefore is a critical step in the examination process.
- C. Some agents will utilize a “draft 5701” or similar discussion when they are unsure of an issue that they are considering asserting. This allows for a more informal and full discussion of the issue before it is formally asserted. Again, this excellent practice improves the communication between agent and taxpayer. Taxpayers should ask to receive draft 5701s at the initial conference discussing examination procedures and expectations.

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

XIX. Revenue agents have limited ability to settle issues.

- A. Typically, revenue agents do not have authority to settle legal issues based on a hazards of litigation assessment.
- 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. I.R.M. § 4.46.3.7. to 4.46.3.7.7.
- C. In an LB&I examination, 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 4-24; I.R.M. § 4.46.5.5.4.
- D. In an LB&I examination, if an issue is a CCI, 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 4-25; I.R.M. § 4.46.5.6.

## **If the Revenue Agents Are Being Difficult, Are There Special Procedures I Can Use to Get Issues Resolved at the Examination Level?**

XX. 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 Technical Expedited Advice Memorandum (TEAM). Rev. Proc. 2012-2.

- B. The benefit of a TAM versus Field Advice is that the taxpayer will be fully involved in the process. The disadvantage for the exam team is that TAMs frequently take longer and the examination team is largely cut out of the discussion.
- C. 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.
- D. The taxpayer makes a written submission on the facts and applicable law, and will have a conference with the National Office.
- E. The examining agents will follow the technical advice that they receive. At Appeals, an unfavorable TAM will not foreclose settlement possibilities.

XXI. The taxpayer and the revenue agents can seek to resolve certain audit issues under a Fast Track Dispute Resolution process. Rev. Proc. 2003-40.

- 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 for Large and Mid-Sized Business taxpayers on April 4, 2003. IRS News Release IR-2003-44. The program has been expanded to Tax Exempt and Governmental Entities taxpayers and Small Business/Self Employed taxpayers. IRS Announcement 2008-105; IRS Announcement 2011-5.
- B. 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. See Rev. Proc. 2003-40 for a description of the LB&I eligibility criteria, the application process, and the settlement process. *See also* I.R.M. § 4.51.4.
- C. Issues must be fully developed, and the taxpayer must state its position in writing.
- D. Agreements are reflected in closing agreements. If no agreement is reached, the issues can be protested to Appeals.
- E. A change was made in 2010 to give the examining agent credit for closing the exam when a case moves to Fast Track Settlement. This change was made to encourage use of the program. IRS News Release IR-2010-98.
- F. The IRS website has information on fast track:  
<http://www.irs.gov/businesses/article/0,,id=111879,00.html>

## XXII. 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; I.R.M. §§ 4.46.5.6.10 and 8.26.4.
- 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. CCIs can also 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.
- F. The IRS website has information on the early referral program:  
<http://www.irs.gov/businesses/article/0,,id=180746,00.html>

## XXIII. 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; I.R.M. § 4.46.5.6.8 (“Accelerated Issue Resolution (AIR)”).
- 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.
- D. The IRS website has information on the AIR program:  
<http://www.irs.gov/businesses/article/0,,id=180752,00.html>

## XXIV. 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.

- D. The function of IIR is not to horse trade in order to reach an industry compromise.
- E. The IRS website has an IRR fact sheet:  
<http://www.irs.gov/businesses/article/0,,id=210773,00.html>

XXV. The Comprehensive Case Resolution (CCR) Program

- A. This program was first announced as a time-limited pilot program, but then was extended to allow for additional applications. Notice 2000-43; Notice 2001-13.
- B. The program, which is jointly administered by LB&I, Appeals, and possibly Office of Chief Counsel (if a case is docketed), allows a taxpayer to request resolution of all issues for all open years in exam, in Appeals, and even in docketed Tax Court cases.
- C. According to the IRS and taxpayers, the CCR program has not been as successful as other IRS issue resolution programs.
- D. The IRS website has information on the CCR program:  
<http://www.irs.gov/businesses/article/0,,id=180736,00.html>

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

XXVI. 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*, 250 F. Supp. 2d 748 (E.D. Mich. 2003).

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

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

- A. Code §6212 says that if the examination determines there is a deficiency in tax, the IRS is authorized to issue a statutory notice of deficiency (a/k/a statutory notice, stat notice, or 90-day letter).
- B. Code § 6213 provides that the IRS generally is prevented from making an assessment until after it has issued a statutory notice.
- C. The agents usually do not end the examination process by issuing a statutory notice. Normally, the agents will issue a 30-day letter, which transmits a RAR containing their proposed adjustments.
- D. 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.

- E. 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.
- F. The issuance of the 30-day letter (or a notice of deficiency) 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. Alternatively, the taxpayer can make a cash deposit to stop the running of interest. If a deposit is made, the taxpayer can request that it be returned. Code § 6603.

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

XXVIII. Three options are 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 immediate assessment, but will issue a statutory notice of deficiency. I.R.M. § 4.8.9.3.
  - 2. Alternatively, the taxpayer can respond to the 30-day letter and affirmatively request that the IRS issue the statutory notice.
  - 3. 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. Once the petition is filed, the taxpayer can pay the deficiency to stop the running of interest.
  - 4. As an alternative to filing a Tax Court petition, 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. Treas. Reg. § 601.105(d).
  - 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.

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

#### **XXIX. 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 with the IRS, before incurring litigation expenses. Unlike exam, Appeals is able to settle issues on a hazards of litigation basis. I.R.M. § 8.6.4.
    - b. You keep open your options to proceed to all litigation forums (see below).
    - c. You can delay payment of proposed tax increases. Hot interest, however, begins to accumulate after the 30-day letter.
    - d. You can learn more about the IRS's position, continue to develop your facts, and refine your own arguments.
  2. Why not protest?
    - a. You may not want the delay, if you plan to litigate as soon as possible. Also, you may want to pay to stop hot interest.
    - 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 not raised on audit. But see Policy Statement 8-2 (Appeals will not raise new issues unless the "ground for such action is a substantial one and the potential effect upon the tax liability is material"). I.R.M. § 1.2.17.1.2 ("Policy Statement 8-2 (Formerly P-8-49)"); I.R.M. § 8.6.1.6.

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

- B. Contents of the Protest
  1. IRS specifies the required form and contents of the protest. Publication 5.
    - a. Taxpayers can file either a full or a skeletal protest. If the taxpayer is serious about settlement, a full protest is desirable.

- b. Taxpayers can raise affirmative issues in the protest. I.R.M. § 8.6.1.6.4.
- 2. The taxpayer must sign 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 to the protest
  - 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," Section XXX.B, below.

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

- E. Appeals may and probably 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.
  - 3. Open-ended extensions should not be used. Form 870-AD extensions for limited time periods allow the taxpayer more control over the timing and pace of the proceedings.

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

#### **XXX. 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 an Appeals Team Chief Leader and Appeals Officers.
3. As discussed below, if a case has a coordinated issue an Appeals Officer responsible for the coordinated will be consulted and may be part of the Appeals team.

B. Ex Parte Communications

1. As mentioned above, prior to the opening conference there will be an “ex parte” conference attended by representatives of the exam team, Appeals and the taxpayer (unless the taxpayer declines to attend). The purpose of the meeting is for Appeals to hear exam’s reactions to the protest.
2. 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. 2012-18; Rev. Proc. 2000-43.
3. These procedures are meant to ensure that Appeals is an independent and flexible vehicle for settling audit and collection-related disputes between taxpayers and the IRS.
4. 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.
5. 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 Appeals conferences

1. The taxpayer should consider if its in-house representatives should attend.
2. If taxpayer representatives with in depth knowledge of the facts attend, they may feel pressure to respond to factual questions at the conference, without taking time to consider the questions and reflect on possible responses.
3. If taxpayer representatives with authority to settle attend, they may feel pressure to respond to settlement proposals without the ability to reflect on those proposals.
4. Expert consultants may attend. This can be useful when technical issues are involved.

## **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. Policy Statement P-1-1, I.R.M. § 8.6.4.1.
  - 2. Appeals should apply a "hazards of litigation" standard in considering settlement of issues.
    - a. Such a settlement can involve mutual concessions on a single issue. Policy Statement P-8-47; I.R.M. § 8.6.4.1.1.
    - b. Such a settlement also can involve "splitting" issues to arrive at a mutually agreeable settlement. Policy Statement P-8-48; I.R.M. § 8.6.4.1.2.
  - 3. Appeals is not supposed to extract "nuisance" settlements from taxpayers. I.R.M. § 8.6.4.1.3. This usually is understood to mean that if Appeals believes the hazards of litigation exceed 80 percent, then Appeals should concede the issue.
- 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); I.R.M. § 8.6.1.6 ("New Issues and Reopening Closed Issues"); I.R.M. § 1.2.17.1.2 ("Policy Statement 8-2").
  - 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 Field counsel or National Office counsel. I.R.M. § 33.1.

## **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. IRS 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. These are issues of Service-wide impact or importance that requires Appeals' coordination to ensure uniformity and consistency nationwide. This is achieved through the coordination of efforts between Appeals officers and designated Appeals Technical Guidance Coordinators (TGC). The ACI program encompasses both legal issues and factual issues. I.R.M. § 8.7.3.2.2.
2. An Appeals officer assigned a case with an ACI must consult with the TGC prior to the scheduling of the initial conference to obtain current information. For ACIs, the Appeals officer must get review and concurrence from the TGC prior to discussing the settlement with the taxpayer. Such review and concurrence extends to all aspects of the settlement including closing documents.
3. A current list of the Appeals Settlement Guidelines (ASGs) can be found at <http://www.irs.gov/individuals/article/0,,id=108655,00.html>.

### **I. Appeals also may identify Appeals Emerging Issues, which have not yet reached the level of an ACI. For these issues, review and concurrence of the TGC is not necessary, but the Appeals officer is required to remain in contact with the TGC. I.R.M. § 8.7.3.2.3.**

### **J. Compliance Coordinated Issue (CCI)**

1. When Exam coordinates an issue and issues a Coordinated Issue Paper (CIP), Appeals designates the issue as a Compliance Coordinated Issue (CCI). I.R.M. § 8.7.3.2.1.
2. Appeals generally develops Appeals Settlement Guidelines (ASG) for CCIs.
3. Effective with the date of the issuance of a CIP, the AO must get the review and concurrence of the Appeals' TGC before discussing the settlement with the taxpayer.
4. The IRS website has a list of CCIs:  
<http://www.irs.gov/businesses/article/0,,id=96445,00.html>.

**If My Appeals Officers Are Being Difficult, Are There Special Procedures  
I Can Use to Resolve Issues at the Appeals Level?**

**K.     Technical Advice Requests**

1.     The taxpayer or the Appeals officer can file a request for technical advice with the IRS National Office. Rev. Proc. 2012-2.
2.     If the TAM favors the taxpayer, Appeals will follow the TAM.
3.     If the TAM favors the IRS, Appeals still is able to concede or settle the issue.
4.     Appeals officers also are able to request more informal legal advice from Field Counsel.

**L.     Appeals Mediation Program. Code § 7123(b)(1).**

1.     Mediation is available for certain cases that are already in the Appeals process, but only after Appeals settlement discussions are unsuccessful and, generally, when all other issues are resolved but for the issues for which mediation is being requested
2.     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). The program was expanded to additional types of cases in 2009. Rev. Proc. 2009-44; I.R.M. § 8.26.5 (“Post Appeals Mediation (PAM) Procedures for Non-Collection Cases”).
3.     An Appeals officer will be supplied by the IRS as a mediator. The taxpayer may elect a non-IRS co-mediator at his/her own expense.
4.     The following issues are eligible for mediation: factual issues, legal issues, CCI issues, ACI issues, an early referral issue (see Rev. Proc 99-28), issues for which a request for competent authority assistance has not yet been filed, unsuccessful attempts to enter in to a closing agreement (see Code § 7121), and offer in compromise and Trust Fund Recovery Penalty cases (see IRS Announcement 2011-6).

**M.     Appeals Arbitration Program. Code § 7123(b)(1).**

1.     Generally, this program is available for cases in which a limited number of factual issues remain unresolved following settlement discussions in Appeals.
2.     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). The program

was permanently established in 2006. IR 2006-163 (10/182006); Rev. Proc. 2006-44; IRS Announcement 2008-111; I.R.M. § 8.26.6 (“Appeals Arbitration Procedures (Non-Collection Cases)”) and § 35.5.5 (“Arbitration and Mediation”). See IRS Announcements 2008-111 and 2011-6.

3. The parties must agree to select an arbitrator from IRS Appeals or from a national organization with a roster or neutrals.
4. Arbitration is available only for factual issues.

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

#### **XXXI. Conclusion of the Appeals process**

- A. A resolution of issues at Appeals can be effected through a closing agreement. Code § 7121; Form 906.
- B. A closing agreement may be entered into in any case in which there appears to be an advantage in having the case permanently and conclusively closed, or if good and sufficient reasons are shown by the taxpayer for desiring a closing agreement. Treas. Reg. §301.7121-1(a) ; I.R.M. §8.13.1.
- C. In many, if not most instances, however, taxpayers and Appeals will use Form 870-AD to close the case out of Appeals. I.R.M. §§ 8.6.4.1.1 and 8.6.4.3. A Form 870-AD waives the restrictions on assessment and allows the IRS to assess the tax agreed to. While a Form 870-AD agreement does not have the same finality as a closing agreement, the form contains a pledge by the IRS not to reopen the case once the agreement is executed.
- D. There are three major options for closing a case out of Appeals using Form 870-AD. The correct option to use depends on what subsequent course of action the taxpayer seeks to take.

### **If I Want to Finally Resolve the Case by Settling All of the Issues, What Do I Do?**

- E. 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. The Form 870-AD contains a pledge by both parties not to reopen the case and, under the doctrine of equitable estoppel, the Form 870-AD is intended to have binding effect on both parties.

4. If an issue recurs in subsequent years, the settlement reached in the current year is not binding in subsequent years. I.R.M. § 8.6.4.1.8(1). Nevertheless, once a “precedent” is set with Appeals it generally is difficult to negotiate a more favorable settlement in subsequent years, absent a change in facts or law.
5. If the settlement reached has effects in subsequent years, is may be desirable to execute a closing agreement. I.R.M. §§ 8.6.4.1.8(2) and 8.6.4.3.3.

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

- F. Option #2 – Partially agreed case, with unagreed issues reserved for litigation in district court or the Court of Federal Claims. This is typically referred to as a “Settlement with Reservations.”
1. Compute the deficiency or overassessment due based on (i) resolving the settled issues as agreed and (ii) resolving the unagreed issues to be reserved for litigation in favor of the IRS.
  2. Execute Form 870-AD reflecting the resulting deficiency, listing the issues that are unagreed and that will be reserved for litigation, and reserving the right to file a refund claim with respect to reserved issues. I.R.M. § 8.6.4.4.2 (“Modification of Agreement for Settlements with Reservations”).
  3. The Form 870-AD is a waiver of the IRS’s restrictions on assessment. The IRS will assess the tax due with respect to both the agreed issues and the unagreed issues and send the taxpayer a notice demanding payment.
  4. Thereafter, 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. (See below)
  6. If the government fails to reserve an issue, that issue cannot be raised, except as an offset in refund litigation. (See below)

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

- G. Option #3 – Partially agreed case, with unagreed issues left for litigation in the Tax Court. This typically is referred to as a “Partial Agreement.”
1. Compute the deficiency or overassessment due based on (i) resolving the settled issues as agreed and (ii) resolving the unagreed issues not settled in favor of the taxpayer.
  2. Execute Form 870-AD reflecting the agreed deficiency, listing the issues that have been settled. I.R.M. § 8.6.4.4.1.
  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 of the agreed 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 to Not Lose My Rights?**

XXXII. Preparation for Refund Litigation

- A. The required first step is to file a Claim for Refund. Code § 7422(a).
- 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. Code § 6511(a).
  2. If a Form 872 agreement extending the period of assessment has been executed, the claim must be filed within six months following the expiration of the extended assessment period. Code § 6511(c). See Form 872.

3. Alternatively, a claim for refund can be filed within two years of the date a payment is made, but limited to the amount of that payment. Code § 6511(a).
- 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. When the taxpayer signs the Form 870-AD, it agrees not to reopen the matters settled with the IRS. This agreement is not fully binding, because the Form 870-AD is not a closing agreement under Code § 7121. The taxpayer could be barred from reopening the agreement, however, under an estoppel theory.
- 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.
  2. Be careful to consider whether raising an issue will have collateral tax effects. If so, those tax effects should be claimed as well.
- 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 or 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 (Apr. 26, 1976). 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. This notice is critical as it starts the limitations period for filing suit.

### **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 mailing 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. Code § 6532(a)(3). Note that using this form can create confusion regarding when the limitations period begins to run.
  3. The statute of limitations for filing suit can be extended using Form 907, if the IRS agrees to execute that form. Code § 6532(a)(2).

### **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 can file suit 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. Code § 6532(a)(1).
  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 (Apr. 26, 1976).

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

**XXXIII. 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 I Should Consider?**

**XXXIV. 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.

- c. In the Tax Court, trial will be to a judge, who will decide the case.

### **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 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 usually will be from one of the regional litigation sections of the Tax Division of the Justice Department.
- g. The 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. An 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 will be 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 generally 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” issues 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 issues, 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.**

- XXXV. As taxpayers progress through the pre-litigation, administrative stage, they should have in mind their ultimate goal, and whether they expect that litigation may be necessary to achieve that goal.
  - A. Is the issue under examination one that 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.
  - B. 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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