

Steptoe

Tax Procedure Outline: Audit, Appeals, and Litigation

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Step toe Tax Procedure Outline: Audit, Appeals, and 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.

Although this outline describes rules and procedures available to taxpayers generally, special attention is accorded to larger taxpayers that are examined by the IRS's Large Business & International (LB&I) Division. These examinations tend to be more lengthy and complex.

Additional analysis on tax procedure, with an orientation toward issues that arise in international tax controversies, is contained in the Steptoe's book, *International Tax Controversies – A Practical Guide*, published by the Practising Law Institute (2018 ed.).

When the Business Engages in a Tax Sensitive Transaction, What Document Creation, Retention, and Privilege Issues Should I Consider?

1. Before, during, and after a transaction, tax counsel must sensitize business participants in the transaction to the reality that they are creating a written record that likely will come under scrutiny in any subsequent tax controversy.
 - A. Most business documents (paper and electronic), and the statements made therein, cannot be protected as confidential or privileged.
 - i. The attorney-client privilege protects only confidential communications between an attorney and a client in the course of their professional relationship, not business communications.
 - ii. The Code § 7525 privilege protects only communications between a “federally authorized tax practitioner” and a client.

- iii. The work product doctrine primarily protects materials that contain an attorney's mental impressions, conclusions, or analysis prepared in anticipation of or in the course of litigation.
 - B. Participants in the transaction must be sensitized that their statements and comments will not be protected against disclosure and that, as a result, they should avoid making written communications (including emails) 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. Participants also should be admonished against making flip, caustic, or joking statements, which email seems to encourage.
 - C. Ill-considered statements in documents and emails may cause the IRS to take a heightened interest in a transaction and serve as an audit roadmap for the IRS.
 - D. Off-hand observations in documents and emails regarding the facts of the transaction, the business purpose of the transaction, and the merits of issues may undermine the taxpayer's position during the IRS examination, in IRS settlement negotiations, and in any subsequent litigation.
 - E. Statements made by a participant in the transaction, and reduced to writing, may be used by the IRS when that participant is questioned by the IRS during the examination. If the person who makes the statement is later a witness in litigation, their prior statement may be used to attack their credibility and to impeach their testimony.
2. Be sure to document the business purpose for the transaction.
- A. When business purposes are discussed, memorialize those discussions in detail in written documents.
 - B. Contemporaneous documentation of non-tax business purpose often is critical in subsequent examinations and litigation.
3. Be sure to compile and maintain all information and documents relevant to the transaction. Code § 6001 requires adequate recordkeeping.
- A. Be aware that certain records are specifically required to be maintained. *E.g.*, Code §§ 6038, 6038A, 6038C.
 - B. Compile and maintain documents that relate to the structure of the transaction, the implementation of the transaction, the business purpose for the transaction, and other relevant issues.
 - i. The Code, regulations, court decisions, and IRS materials (audit guides, settlement guidelines, IRM sections, etc.) often address what information

is relevant and important when particular transactions are examined and litigated. This information should be compiled and maintained.

- C. Document the identities of participants in the transaction and memorialize critical facts and analyses.
 - D. Remember to preserve relevant emails and electronic files (so-called electronically stored information or ESI). 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.
 - E. Maintain documents in a centralized location where they are clearly labeled, readily available, and protected from being misplaced or destroyed.
 - F. Maintain documents for time periods that are appropriate in light of the applicable statutes of limitations for the periods affected by the transaction.
4. 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. When a retention period is ending, 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.
5. Once the relevant documents have been compiled, handle them in ways that maintain applicable privileges and protections.

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- 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 also for all documents that address the same “subject matter.”
 - E. Under the “common interest rule” (also referred to as the “joint defense privilege”) disclosure to a third party will not constitute a waiver if those parties have a common legal, rather than commercial, interest and the disclosure is made in the course of formulating a common legal strategy. *See Schaeffler v. United States*, 22 Supp. 3d 319 (D.C.N.Y 2014).
6. When controversy is expected, taxpayers should institute a “litigation hold,” which instructs record keepers to maintain and not destroy relevant documents.
- A. Failure to institute a “litigation hold,” with the result that documents are destroyed, may lead to a charge of “spoliation.” (See above.)
 - B. 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 truly anticipated litigation, it should have instituted a litigation hold.
 - C. 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 identified and retained.
7. Subsequent defensive actions, taken during IRS examinations and in litigation, can cause a waiver of privilege.
- A. Often, a taxpayer will seek to avoid Code § 6662 accuracy related penalties by disclosing pre-transaction closing tax opinions received from tax advisors. These intentional disclosures, however, may cause a subject matter waiver of attorney-client privilege or work product protection otherwise available to other undisclosed documents that concern the same “subject matter.” *See Salem Financial, Inc. v. United States*, 102 Fed. Cl. 793 (Ct. Fed. Cl. 2012).
 - B. The issue also may arise whether the disclosure of a pre-closing tax opinion as a defense to penalties waives privilege for undisclosed, post-closing advice from the same tax advisor regarding proposed changes in law and the unwinding of the

challenged transaction. On these facts it has been held that a subject matter waiver occurred, based on a finding that the pre-closing tax opinion and the post-closing advice on proposed law changes and the unwinding of the transaction concerned the same subject matter, i.e., the “proper tax treatment” of the transaction. *See Salem Financial, Inc. v. United States*, 102 Fed. Cl. 793 (Ct. Fed. Cl. 2012). The opposite conclusion, however, also has been reached. *Santander Holdings USA, Inc. v. United States*, 110 AFTR 2d 2012-5481 (D. Mass. 2012) (holding that the pre-closing advice and the post-closing advice concerned “different subject matters”).

- C. In *Ad Investment 2000 Fund LLC v. Commissioner*, 142 T.C. 139 (2014), the Tax Court held that the attorney-client privilege otherwise available to undisclosed tax opinions can be waived even if a taxpayer does not rely on those opinions as part of its penalty defense, but instead relies on its own reasonable cause and reasonable belief. This opinion affirms that privileged tax opinions are placed in serious jeopardy whenever a taxpayer defends against the assertion of penalties.

Can I Be Proactive and Resolve Tax Issues Before the Return Is Filed?

- 8. Some issues can be resolved under the IRS’s Pre-Filing Agreement (PFA) Program.
 - A. A PFA can be used to resolve factual issues, issues involving the application of well-established legal principles to stipulated facts, and issues involving a methodology used by a taxpayer to determine the appropriate amount of an item of income, allowance, deduction, or credit. Rev. Proc. 2016-30, § 3.03; I.R.M. 4.30.1.
 - B. PFAs cannot be used to resolve certain specified issues, such as transfer pricing. Rev. Proc. 2016-30, § 3.08. If the taxpayer wants comfort regarding a legal issue that is not well-settled, the taxpayer can request a private letter ruling. Rev. Proc. 2018-1.
 - C. A PFA that makes determinations for the current taxable year (and any prior taxable year for which a return is not yet due) is a closing agreement under Code § 7121. A PFA that makes a determination for one or more future taxable years as well as for the current taxable year (and any prior taxable year for which a return is not yet due) is a non-statutory agreement. Although not a closing agreement under Code § 7121, this type of PFA is a binding contract between the IRS and the taxpayer, subject to any legislative enactment that is applicable to the taxable years to which the PFA relates. There is no prescribed format for such an agreement. Rev. Proc. 2016-30, § 7.

- D. The user fee for PFA requests submitted on or after February 1, 2018, is \$174,000.
- E. The IRS website contains information regarding PFAs at <https://www.irs.gov/businesses/pre-filing-agreement-program>.
- F. The impact of new Issue Campaign process (discussed below) on the resource intensive PFA process is yet to be determined.

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

- 9. Disclosure of Issues on the Tax Return, In General.
 - 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, some accuracy-related penalties may be avoided. Code §§ 6662(d)(2)(B)(ii) and 6662A; Rev. Proc. 2014-15, § 3.03.
 - i. Negligence penalty: Mere reporting will not prevent a penalty. Treas. Reg. § 1.6662-7(b). A negligence penalty can be avoided by showing that there was a reasonable basis for the reported tax position.
 - ii. Disregard of rules or regulations penalty: Can avoid this penalty by disclosing and having a reasonable basis. Treas. Reg. § 1.6662-3(a).
 - iii. Substantial understatement penalty: Can avoid this penalty by disclosing and having a reasonable basis. Code § 6662(d)(2)(B)(ii) and Treas. Reg. § 1.6662-7(b). The substantial understatement penalty also can be avoided if there was substantial authority for the position.
 - iv. All of the foregoing penalties, and the fraud penalty, can be avoided by showing that there was reasonable cause for the position and that the taxpayer acted in good faith.
 - v. Reportable transaction understatement penalty: Can avoid this penalty by disclosing, having substantial authority, and having a belief the position is more likely than not correct. Code § 6664(d)(3).
 - B. The foregoing rules will differ if the tax position involves a tax shelter. Code §§ 6662, 6664.
 - C. Failing to disclose will increase a Code § 6662A penalty from 20% to 30% and a Code § 6662(b)(6) economic substance penalty from 20% to 40%.

- D. Disclosures are made using Form 8275 or Form 8275-R (for positions contrary to Treasury regulations). Treas. Reg. § 1.6662-4(f).
- E. Disclosure on Form 1120 Schedule UTP satisfies the disclosure requirement; a separate Form 8275 or Form 8275-R need not be filed. Rev. Proc. 2014-15, § 3.07; Instructions for IRS Form 1120 Schedule UTP (2013).
 - i. Taxpayers are required to file Form 1120 Schedule UTP and disclose their uncertain tax positions. Treas. Reg. § 1.6012-2(a)(4).
 - ii. 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 (2015).
- F. Disclosures will not avoid or reduce Code § 6662 penalties if the item is attributable to a tax shelter. In addition, the penalty will be imposed if the item is not properly substantiated or if the taxpayer lacks adequate books or records. Treas. Reg. § 1.6662-4(a).

Can and Should I Disclose Transactions That May Be a “Tax Shelter”?

10. “Tax Shelter” Disclosures

- A. Code § 6011 may require a disclosure.
 - i. Pursuant to Code § 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.
 - ii. 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).
 - iii. 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. § 1.6011-4(b).

- iv. Disclosure must be made on Form 8886. Currently, disclosure on Form 1120 Schedule UTP satisfies the disclosure requirement. Rev. Proc. 2014-15, § 3.07; IRS Announcement 2010-75. Taxpayers will need to disclose tax shelters resulting in tax reserves on the Schedule UTP form.
 - v. Disclosures must be made for transactions that subsequently are identified by the IRS as a listed transaction or a transaction of interest. Treas. Reg. § 1.6011-4(e)(2).
 - vi. The failure of a taxpayer to make a required disclosure 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 § 6662A imposes a 20% accuracy-related penalty on “reportable transaction understatements.” For purposes of Code § 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% if the transaction is not properly disclosed by the taxpayer.
- C. Code § 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% 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 § 6707A penalty can be imposed in addition to the Code § 6662 or the Code § 6662A accuracy-related penalties. 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 avoid exposure to accuracy-related penalties. Code § 6662(d)(2)(C); Treas. Reg. § 1.6662-4(e)(2).
- i. Penalties may be avoided by declining to claim the tax benefits associated with the item on the original return, 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). But, beware of Code § 6676 penalties.

- ii. Penalties also can be avoided by filing a timely Qualified Amended Return (see 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% accuracy-related penalty applies for understatements with respect to reportable transactions. Code § 6662A. Failure to disclose the transaction increases the penalty to 30%. Code § 6662A(c).
- F. For transactions entered into after March 30, 2010, a strict liability 20% penalty applies for nondisclosed noneconomic substance transactions. Code § 6662(b)(6). Failure to disclose increases the penalty to 40%. 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% 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 § 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. Proposed regulations would give the IRS the discretion to grant an extension of the 20-day period. Prop. Reg. § 301.6708-1(c)(3).

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

- 11. 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; (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 IRS 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 IRS 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 § 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).

12. “Audit File” Disclosures

- A. Errors, affirmative issues, and other items can be disclosed by a taxpayer subject to examination by LB&I 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.
 - i. This disclosure procedure will not prevent imposition of penalties if the disclosed item is attributable to a tax shelter.
 - ii. Disclosure of issues up front may help to create a better relationship with Exam.
- B. Such disclosures are treated as informal claims for refund. LB&I’s Publication 5125 (Feb. 2016) states that “LB&I will only accept informal claims that are provided to the exam team within 30 calendar days of the opening conference.” These informal claims must meet the standards of Treas. Reg. § 301.6402-2.

- C. Any claims filed after the 30-day period must be formal claims on Form 1120X or Form 843 and also meet the standards of Treas. Reg. § 301.6402-2. Claims failing to meet those standards will be summarily disallowed.

If I want to Discuss Penalty Issues with the IRS How Should I Correctly Fill Out the Form 2848?

- 13. In the context of international information returns, the IRS has ruled that Forms 2848 that only list a specific tax return will cover penalties only related to that specific tax return. CCA 201736021 (2017).

How Does the IRS Conduct a Field Exam?

- 14. 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.
 - i. 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. Code § 7605(a) and (b).
 - ii. 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. Taxpayers, other than large taxpayers subject to audit by LB&I (to which special rules apply, discussed below), should ask the IRS for an audit plan and a timetable.
 - i. Taxpayers should seek to negotiate the scope and timing of the audit.
 - ii. 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 to create a record of information provided orally and IRS positions or representations.
 - iii. 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 (see below)).

- C. LB&I-audited taxpayers are subject to more formal LB&I examination procedures. As described below, these procedures have changed on a regular basis over time, and likely will continue to change.
- i. Prior to 2015, large taxpayers were subject to LB&I's Quality Examination Process (QEP). Publication 4837; QEP Reference Guide (10/2010).
 - (1) QEP required an initial audit meeting, at which the taxpayer identified the individuals to be contact points during the audit. In large cases, one revenue agent was identified as the case manager to lead a team of agents. The case manager developed the audit plan and determined the scope of the audit. Another agent was appointed the team coordinator. International, employee plan, financial product, employment tax, excise, actuaries, or other special examiners were brought in for special roles.
 - (2) The taxpayer and the agents discussed the audit plan and agreed on how the audit will be conducted, the Exam team's audit plan, and the procedures for IDRs and other communications.
 - (3) Taxpayers were interested in including the following topics in the audit agreement: advance discussion of issues, receiving draft IDRs, taxpayer activity black-out periods, use of presentations in lieu of IDR responses, and discussion of IRS risk analyses.
 - ii. The QEP examination process was replaced by LB&I's Publication 5125 (July 2014; Feb. 2016), for cases starting as of May 1, 2016. *See* <https://www.irs.gov/businesses/corporations/large-business-and-international-examination-process>.
 - (1) The stated goals of the Publication 5125 examination process are working transparently and collaboratively with the taxpayer, applying the law to the facts in a fair and impartial manner, and resolving issues at the lowest possible level.
 - (2) For LB&I's technical resources and guidance see <https://www.irs.gov/businesses/corporations/lbi-technical-resources-and-guidance>.
 - (3) Generally, the new LB&I exam process involves "issue-based principles" and "issue-driven risk analysis." I.R.M. § 4.46.1. The goal is to focus on issues with material tax risk and significant compliance impact. To achieve this, LB&I will identify the issues presenting the most risk and assign "issue teams" to examine those issues. Each such issue will be assigned to an "issue team" that

will develop and manage the issue. LB&I refers to these as “compliance campaigns.”

- (4) LB&I and the taxpayer are expected to work collaboratively to select issues to be examined, plan and conduct the audit, establish and follow timelines, and achieve resolutions.
- (5) An important change in the examination process is that LB&I will now accept informal refund claims only if they are submitted within 30 days of the opening conference. After that 30-day period, formal claims that meet the stricter standards of Treas. Reg. § 301.6402-2 must be submitted on Form 1120x.
- (6) As part of the compliance campaign program, and perhaps before an examination has begun, the taxpayer may receive a so-called “soft letter.” The soft letter may inquire about a tax position the taxpayer has taken or may request that the taxpayer take some action, such as providing specified information. Taxpayers are not required to respond to a soft letter, but failing to do so may trigger an examination.
- (7) There are three stages in the new examination process. The first stage is planning. In initial planning meetings, the taxpayer and Exam work together to set the scope of the examination, develop examination procedures, and schedule meetings to monitor progress. Issues to be examined will be identified and discussed. Rather than a case-based exam process, each issue will be addressed by identified LB&I and taxpayer “issue teams.” At the conclusion of the planning phase, LB&I and the taxpayer will agree to an issue-focused “final examination plan.”
- (8) The second stage is execution. LB&I and taxpayers will actively discuss legal and factual issues. During this process, Exam will follow LB&I’s formal IDR procedure (discussed below). LB&I will develop the facts and seek the taxpayer’s written concurrence to a written factual statement presented in an IDR.
 - (A) LB&I’s proposed fact statement regarding an issue is not accompanied by an explanation of LB&I’s legal analysis. This makes it difficult for the taxpayer to respond to the fact statement.
 - (B) Taxpayers are not required to respond to LB&I’s written fact statement. In some circumstances, not responding to the fact statement may be prudent.

- (i) Exam's fact statements may have opinions, omitted facts, and facts that are "spun" a particular way. Taxpayers need to be careful about giving credence to Exam's potential bias
 - (ii) If the taxpayer agrees to LB&I's written fact statement, that act may later be construed as a factual admission and used against the taxpayer.
 - (iii) Alternatively, the taxpayer can prepare its own written fact statement and ask that it be included in the IRS's files. Indeed, the taxpayer can offer to prepare the fact statement in lieu of having LB&I prepare it.
 - (iv) As discussed below, if LB&I's fact statement omits relevant facts, the taxpayer fails to provide those facts to Exam, and then the taxpayer raises the omitted facts at Appeals, Appeals may return the case to LB&I for verification.
 - (v) To be proactive and possibly avoid issues, taxpayers can provide fact statements to Exam, in advance of receiving Exam's proposed fact statement.
- (9) The third stage is resolution. LB&I will utilize appropriate resolution strategies. Fast Track Settlement (discussed below) must be considered for all unagreed issues. For unagreed issues, the taxpayer is responsible to ensure that all facts and legal arguments are included in Forms 5701 and available to be presented to Appeals. At the end of the exam, LB&I and the taxpayer may perform a joint critique of the exam process.
- (10) In this process, when a "Team Coordinator" and "Case Manager" have been assigned, it is unclear how the "issue teams" will effectively coordinate their activities. During the planning stage, taxpayers will want to negotiate processes to coordinate IDRs from the various issue teams, to avoid being swamped with simultaneous IDRs and to obtain reasonable response deadlines. In addition, if there are multiple unagreed issues, the taxpayer will want to ensure that the Fast Track Settlement schedules for the various issues are coordinated.
- (11) Also, the Publication 5125 examination process will be significantly impacted by the new Issue Campaign process (discussed below).

- iii. LB&I directives can be found at <https://www.irs.gov/businesses/corporations/large-business-and-international-lbi-industry-director-guidance>.

What Is the Special “CAP” Audit Program?

- 15. 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. §§ 4.51.8 and 4.60.1-3.
 - A. 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.
 - B. If issues are agreed, they are memorialized in a closing agreement. Fast track settlement is available to resolve issues.
 - C. 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).
 - D. If a taxpayer does not adhere to the terms of the MOU, CAP can be terminated. A taxpayer may terminate CAP at any time.
 - E. As of 2015, the IRS continued to expand the CAP program. In 2015, there were 194 taxpayers in CAP. However, no new applications are being accepted in 2018. The following criteria apply for the 2018 CAP tax year: (1) current taxpayers in the CAP and Compliance Maintenance phases may submit applications to participate in the CAP program, (2) current Pre-CAP taxpayers may remain in the Pre-CAP phase, and (3) current CAP taxpayers may be moved into the Compliance Maintenance phase, as appropriate.
 - F. For additional information, see <https://www.irs.gov/businesses/corporations/compliance-assurance-process-cap-frequently-asked-questions-faqs>.
 - G. The impact of new Issue Campaign process (discussed below) on the resource intensive CAP process is yet to be determined.

How Can Exam Obtain Information and Documents?

- 16. Examining agents are authorized to examine books and records, and to examine persons. Code §§ 7601 and 7602(a)(1).

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17. Generally, the IRS issues Information Document Requests (IDRs) on Form 4564.
 - A. It is important for taxpayers to control the IDR process by asking to review draft IDRs before they are issued, negotiating reasonable response due dates, identifying who should be tasked with responding, etc.
18. In 2013, for LB&I audited taxpayers, LB&I set out more formal requirements for the issuance and enforcement of IDRs by LB&I examiners, with the goal being improved communication between examiners and taxpayers. *See* LB&I-04-0214-004.
 - A. Requirements for Issuing IDRs
 - i. After the initial IDRs issued at the beginning of an exam, IDRs must be issue-focused, rather than requests for general information. The issue must be stated in the IDR, and only information relevant to that issue may be requested. Each issue should be addressed with a separate IDR.
 - ii. The examiner is required to speak with the taxpayer about the issue, how the information requested relates to that issue, and must also discuss the contents of the IDR after it is drafted.
 - iii. A response date to the IDR will be set, with taxpayer input, as well as a deadline for review by the examiner regarding whether the information provided by the taxpayer pursuant to the IDR is sufficient.
 - B. If the taxpayer fails to respond or provides an incomplete response, an examiner may grant an extension to a taxpayer for up to 15 business days before the Enforcement Process is triggered.
 - C. The IDR Enforcement Process consists of three mandatory steps, with no exceptions.
 - i. A Delinquency Notice (Letter 5077) will be issued within 10 days of the application of the Enforcement Process. Generally, a response date of 10 days or less will be set.
 - ii. A Pre-Summons Letter (Letter 5078) will be issued if the taxpayer does not provide a complete response to the IDR by the Delinquency Notice response date. It generally will be issued within 10 days of the Delinquency Note response date.
 - iii. A Summons will be issued if the taxpayer continues to fail to provide a complete response to the IDR by the Pre-Summons Letter response date
 - (1) The summons can compel the production of written material and oral testimony.

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19. The IRS can issue a “designated summons” to LB&I-audited taxpayers. Code § 6503(j); I.R.M. § 25.5.3.3.
 - A. Unlike the issuance of an ordinary summons, issuance of a designated summons will toll the running of the statute of limitations on assessment when the IRS begins enforcement proceedings.
 - B. The IRS will issue a designated summons in situations where the taxpayer is not responding to IDRs and is refusing to extend the statute of limitations.
20. If the taxpayer does not respond to the summons, the IRS can go to court to judicially enforce the summons. Code § 7402(b).
 - A. To justify enforcement of the summons, the IRS need only make a prima facie showing that the summons is valid, usually by affidavit. *See United States v. Powell*, 379 U.S. 48, 57-58 (1964).
 - B. The taxpayer may contest the government’s summons in the enforcement proceeding. To get a hearing on the issue, the taxpayer must present some credible evidence to support a claim of improper motive for issuing the summons, rather than bare allegations. *See United States v. Clarke*, 134 S. Ct. 2361 (2014).

Can I Contend Documents Are Privileged or Work Product Protected?

21. Documents requested by the IRS can be withheld if they are attorney-client privileged.
 - A. The elements to establish the attorney client privilege are (1) the holder of the privilege is a client of the attorney, (2) the communication was made by or to an attorney, and (3) the communication was for the purpose of securing legal advice.
 - B. The privilege will not exist if the communication was made in the presence of individuals who were neither attorney nor client, and can be waived if subsequently disclosed to such individuals.
 - C. Taxpayers often seek to avoid Code §§ 6662 and 6662A accuracy related penalties by claiming reasonable cause and good faith under Code §§ 6664(c) or 6664(d). Clearly, when a taxpayer intentionally discloses an otherwise privileged document to the IRS, the taxpayer waives the attorney-client privilege.
 - D. Under Federal Rule of Evidence 502(a), when a taxpayer discloses a document and thereby waives the attorney-client privilege or work product protection for that document, that waiver can cause a “subject matter” waiver as to other undisclosed documents. This broader waiver will occur if (1) the waiver is intentional, (2) the disclosed and undisclosed documents concern the same subject

matter, and (3) the disclosed and undisclosed documents should in fairness be considered together.

- E. To avoid Code §§ 6662 and 6662A penalties under the Code §§ 6664(c) and 6664(d) exceptions, taxpayers may contend that reliance on pre-transaction tax opinions prepared by tax advisors constitutes reasonable cause and good faith. Such a contention, however, can cause a subject matter waiver of attorney-client privilege otherwise available to other undisclosed documents that concern the same “subject matter.” See *Salem Financial, Inc. v. United States*, 102 Fed. Cl. 793 (Ct. Fed. Cl. 2012).
 - F. The same waiver issue was addressed in *Santander Holdings USA, Inc. v. United States*, 110 AFTR 2d 2012-5481 (D. Mass. 2012). There, the District Court expressly rejected the decision by the Court of Federal Claims in *Salem* and held that the pre-closing advice and the post-closing advice on proposed law changes and transaction unwinding concerned “different subject matters.”
 - G. In *Ad Investment 2000 Fund LLC v. Commissioner*, 142 T.C. 139 (2014), the Tax Court held that attorney-client privilege otherwise available to undisclosed tax opinions can be waived even if a taxpayer does not disclose or otherwise rely on those opinions as part of its penalty defense. In its defense against penalties, the taxpayer disavowed reliance on the advice of counsel defense, relying solely on the self-determination penalty defense. The IRS contended that a waiver had occurred, arguing that even under the self-determination defense the “tax opinions remain relevant to the subjective inquiries into reasonableness and good faith.” The court held that, by asserting the self-determination defense, the taxpayer had waived privilege on the tax opinions. See also *Eaton Corp. v. Commissioner*, No. 5576-12 (2015) (Rule 50(f) order).
22. Documents requested by the IRS also can be withheld if they are work product protected.
- A. The work product doctrine protects documents prepared in anticipation of litigation. FRCP § 26.
 - B. A broad interpretation of the prepared in anticipation of litigation requirement is the widely used “because of” test, which asks if the document was prepared because of the prospect of litigation. *United States v. Adlman*, 134 F.3d 1194 (2d Cir. 1998); *United States v. Roxworthy*, 457 F.3d 590 (6th Cir. 2006); *United States v. Deloitte, LLP*, 610 F.3d 129 (D.C. Cir. 2010); *FTC v. Boehringer Ingelheim Pharm, Inc.*, No. 12-5393 (D.C. Cir. 2015).
 - C. A narrower interpretation is the “prepared for” test, which asks if the document was “prepared for possible use in litigation.” The narrower interpretation was adopted in *United States v. Textron*, 577 F.3d 21 (1st Cir. 2009).

23. 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).
- A. 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).
 - B. Taxpayers have claimed that tax accrual workpapers are entitled to attorney-client privilege and work product protection with mixed success. *Compare Textron Inc. v. United States*, 577 F.3d 21 (1st Cir. 2009) with *United States v. Wells Fargo & Co.*, No. 10-57 (D. Minn. June 4, 2013), *Deloitte, LLP v. United States*, 610 F.3d 138 (D.C. Cir. 2010), and *Schaeffler v. United States*, Dkt. No. 14-1965-cv (2d Cir. 11/20/2015).
 - C. 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.
 - D. 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.
 - E. If the taxpayer did not disclose its listed transaction, or engaged in multiple listed transactions, the IRS will request all tax accrual workpapers. *Id.*
24. When a taxpayer claims attorney-client privilege or work product protection the taxpayer must provide a "privilege log."
- A. The log ordinarily will provide information sufficient to allow an analysis of the basis for withholding the document such as the nature of the document, the sender, the recipients, the timing, and the reason why the document is being withheld. See *Pacific Management Group v. Commissioner*, ___ T.C. Memo. ___ (2015).

Can the IRS Seek Documents from Third Parties?

25. The IRS can seek documents from third parties. Code § 7602(a); I.R.M. § 4.11.57.

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- A. Before making contact with third parties, the IRS must give notice to the taxpayer that third-party contacts will be made. Code § 7602(c)(1).
 - B. The IRS must periodically give the taxpayer notice of what third parties have been contacted. Code § 7602(c)(2).
 - C. 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.
 - D. Thus, 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 meeting or interview.
26. The IRS is able to issue summonses to third parties. Code § 7609.
- A. Special notice, timing, and enforcement procedures apply to third-party summonses. Code § 7609; I.R.M. § 25.5.6.
 - i. The IRS must notify the taxpayer of the issuance of the summons. Code § 7609(a).
 - ii. The taxpayer can initiate a judicial proceeding to quash the summons. Code § 7609(b).
 - iii. In addition, the IRS can initiate a proceeding to enforce the summons, and the taxpayer can intervene in that proceeding. Code §§ 7604, 7609(b)(1).

What if Documents Are Located in a Foreign Country?

27. If a U.S. taxpayer fails to respond to an IDR seeking documents held at a foreign location, the IRS may issue a formal document request (FDR) for any “foreign-based documentation.” Code § 982.
- A. If the taxpayer fails to respond to the FDR within 90 days, the taxpayer may be prohibited from introducing the requested documents in any subsequent tax proceeding. Code § 982(a).
 - B. A taxpayer served with an FDR may initiate suit to quash within 90 days of the mailing of the FDR. Doing so will suspend the statute of limitations on assessment.

28. The IRS has tax information exchange relationships with approximately 90 foreign countries in the form of tax treaties, tax information exchange agreements (TIEAs), and mutual legal assistance treaties (MLATs).
 - A. These agreements permit the IRS to make formal requests to the taxing authorities in other countries that information be obtained and forwarded to the IRS.
 - B. The examining agent will prepare an information request, which is forwarded to the U.S. Competent Authority, and from there to the foreign competent authority.
29. In lieu of making a treaty request, the IRS may attempt to obtain foreign information by means of an administrative summons. In such cases, however, judicial enforcement of the summons against a foreign entity may be difficult. *See, e.g., In the Matter of Arawak Trust Co. (Cayman) Ltd.*, 489 F. Supp. 162 (E.D.N.Y. 1980).

Can I Use the FOIA to Get Information from the IRS?

30. Taxpayers can request documents from the IRS pursuant to the Freedom of Information Act (FOIA), 5 U.S.C. § 552.
 - A. The procedures for making a FOIA request are contained in Internal Revenue Manual § 11.3.13 and in the IRS's FOIA Guidelines, https://www.irs.gov/pub/irs-utl/irs_foia_guide.pdf. Fees may be charged for searching, copying, and reviewing documents.
 - B. Although the IRS is required to determine within 20 business days whether to comply with the request, the IRS typically extends the response date. When a significant number of documents are requested, the IRS typically will extend the response date for lengthy periods of time.
 - C. Although all IRS records are subject to FOIA requests, the IRS may withhold documents (or parts of documents) based on exemptions and exclusions in the FOIA statute. 5 U.S.C. § 552(b). Commonly claimed exemptions are information exempted from disclosure by another law (such as Code § 6103) and inter-agency or intra-agency memoranda or letters covered by the deliberative process privilege, the work product privilege, or the attorney-client privilege.
 - D. If the IRS does not respond or withholds documents, the taxpayer may file an administrative appeal with IRS Appeals.
 - E. A taxpayer also may initiate suit in Federal district court. Treas. Reg. § 601.702(c)(13). In such a suit, the IRS must provide a "Vaughn Index," which is an itemized index that links each withheld document (or portion of a document) to a specific FOIA exemption. The court will use the Vaughn Index to determine the

appropriateness of the IRS's determination. *See Schwarz v. United States*, 131 F. Supp. 142, 147 (D.D.C. 2000).

Can the IRS Use Outside Third Parties to Help in the Audit?

31. Contractors hired by IRS or Chief Counsel may receive and examine documents and may participate fully in interviews. Treas. Reg. §§ 301.7602-1(b)(3) (2016); T.D. 9778.
 - A. Contractors may receive books, papers, records, or other data summoned by the IRS. Contractors may also take testimony from a person who the IRS has summoned, but must do so in the presence and under the guidance of an IRS officer or employee.
 - B. The contractor's role is restricted to the performance of functions that are not inherently governmental. T.D. 9669, 9778.

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

32. 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 three 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 or substantial omissions.)
 - 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., Forms 872-F, 872-P, 872-S.)
 - 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 many instances failing to extend is an unattractive option.
 - D. Taxpayers, however, often extend the assessment period for relatively short time periods, so they can retain some control over timing. The IRS 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?

33. As described above, before issuing an IDR to a taxpayer, the LB&I Exam team must discuss the issue with the taxpayer, describe how the information sought relates to the issue, and craft a concise IDR customized to the taxpayer or industry.
 - A. Each IDR should relate to a single issue. Exam should provide a draft IDR to the taxpayer and discuss the contents.
 - B. Exam and the taxpayer then should determine a reasonable response date, which will include a date by which Exam will review and respond to the information provided.
34. If the taxpayer believes that an IDR is overly broad, the taxpayer should discuss with Exam 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.
35. Even with a negotiated IDR, care must be taken to read IDRs 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. Exam may view a narrow response as potentially misleading and a breach of trust.
36. Care must be taken when an IRS request for information encompasses information and documents that are privileged or protected.
 - A. Disclosing the documents to the IRS can cause the permanent loss of an otherwise applicable privilege or protection.
 - i. Partially disclosing portions of a document can cause an implied waiver with respect to the entire document.
 - ii. Likewise, providing a mere description of the substance of a document may cause an implied waiver with respect to the document.
 - iii. Disclosing a document also could cause a subject matter waiver of privilege on all documents that address the same subject.
 - B. To preserve the privilege, a taxpayer can decline to disclose the privileged material, and instead submit a “privilege log” to the IRS.

- i. 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.
 - C. 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.
- 37. 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.
 - A. 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.
 - B. The IRS may record the interview. Alternatively, the examining agents may simply take notes. Testimony can be taken under oath. Code § 7602(a)(2).
 - C. Statements 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.
 - D. Sometimes taxpayers may volunteer employee interviews as a way to reduce the scope of IDRs or to move issues forward. The selection and preparation of employees to be interviewed is critical to their success.
- 38. 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.
 - A. Although these agreements can be beneficial, they also pose risks, and counsel should carefully consider those risks.

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

39. 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 Legal Advice is an alternative to Technical Advice Requests, which are requested by the taxpayer and the Exam team, discussed below.
 - B. Technical Advice is preferred by the IRS when the advice is intended to establish the position of the IRS and when the IRS deems 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, taxpayers 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 facts and legal reasoning and can narrow issues.
 - E. Legal 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.
40. Centralized versus Decentralized Examination Issue Selection and Auditing
- A. From 2006 through 2011, LB&I used an issue tiering approach to identify high-risk tax issues. Major, high-risk compliance issues were identified, audit techniques were developed, and specified case resolutions were determined on a centralized basis.
 - i. The classifications utilized, though no longer in use, illustrate the kinds of issues that may attract IRS attention.
 - (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.
 - (3) Tier III - Industry Risk: These issues have the highest compliance risk for a particular industry and require unique, industry-specific treatment.
- B. In August 2012, LB&I announced that it needed a different approach to manage compliance priorities and that it would no longer manage issues through the tiering process.
- i. LB&I expressly recognized that the Tiered Issue “one size fits all,” centralized management approach was inappropriate.
 - ii. As a replacement, LB&I announced that coordination efforts would utilize Issue Practice Groups (IPGs) and International Practice Networks (IPNs). LB&I-4-0812-010 (2012).
 - iii. This approach deploys and allocates subject matter experts, technical advisors, and IRS counsel personnel in a collaborative manner to develop various issues. The IPG and IPN approach was described as more decentralized, flexible, and informal. Under the new approach, it is easier to treat issues with factual differences accordingly.
 - iv. LB&I stated that “IPGs and IPNs are designed to provide examination teams the technical advice they need to manage their cases efficiently.” LB&I described IPGs and IPNs as “a resource for examiners” and stated that agents “are encouraged to consult IPGs and IPNs.” Thus, IPGs and IPNs were meant to decentralize control down to the Exam team.
 - v. As of January 21, 2014, all Coordinated Issue Papers became de-coordinated. IPGs and IPNs provide guidance to examiners regarding issues that have been de-coordinated. LB&I-04-0114-002 (2014).
- C. In 2014 and 2015, LB&I issued over 60 International Practice Units (IPUs), which identify major international tax compliance issues and provide guidance on approaching those issues.
- i. LB&I stated that the IPUs are “job aids and training materials,” rather than “official pronouncements of law or directives.” Specifically, IPUs “do not limit an IRS examiner’s ability to use other approaches when examining issues.”
 - ii. These IPUs continued the approach of not directing one-size-fits-all examinations and resolutions on a centralized basis.

- D. In September 2015, LB&I announced a “fundamental shift” that moved back to a centralized audit selection process and a “campaign approach” to enforcement. September 18, 2015, LB&I PowerPoint. This approach was reiterated in LB&I’s January 2016, FY2016 Focus Guide (Document 11809).
- i. The rationale for the change is to better utilize LB&I’s scarce resources. The goal is not to automatically audit large taxpayers without a prior determination of the taxpayer’s compliance risk.
 - ii. Thus, the continuous audit model has been replaced by a process where taxpayers to be audited are selected based on an analysis of compliance risk. To implement this new approach, LB&I now is organized into nine “Practice Areas,” which include practice areas for Pass Through Entities, Enterprise Activities, Cross Border Activities, Withholding and International Individual Compliance, and Treaty and Transfer Pricing Operations. LB&I’s FY2016 Focus Guide.
 - iii. These Practice Areas will develop what LB&I calls “Issue Campaigns,” which will assess compliance issues on a centralized basis, using an issue-focused, risk-based process. Important goals of each Issue Campaign are to identify areas of observed or perceived noncompliance and to set expectations of the level of compliance to be achieved. Also, as part of an Issue Campaign, a Practice Group will identify IRS resources to execute the Issue Campaign and provide training, guidance, and other support to audit teams. LB&I’s FY2016 Focus Guide.
 - (A) To date, the IRS has announced numerous issue campaigns, which are listed on the IRS website.
 - iv. Along with centralized issue selection, it is likely that centralized control over examinations will become prevalent. Although LB&I continues to reference Publication 5125 (discussed above), LB&I now states that Issue Campaigns will create “tailored treatment streams to achieve” the specified outcomes. LB&I’s FY2016 Focus Guide.
 - v. Under the Issue Campaign process, centralized examination directives and resolution guidelines may limit or remove the on-site Exam team’s discretion. Centralized control and decision making will result in IDRs, examination procedures, and expected issue resolutions that come from the Issue Campaigns. These missives may be one-size-fits-all.
 - vi. Taxpayers should negotiate and be proactive with Exam, as discussed above in the context of Publication 5125. However, the new centralized audit approach will require that taxpayers seeking to resolve procedural and substantive issues contact the off-site personnel in the Practice Group(s) involved.

41. 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-Businesses-&-Self-Employed/Audit-Techniques-Guides-ATGs>.
42. Industry Issue Resolution (IIR) Program
 - A. The IIR Program resolves frequently disputed or burdensome tax issues that affect a significant number of business taxpayers through the issuance of guidance. The IRS solicits suggestions for issues from taxpayers, representatives, and associations for the IIR Program. For each issue selected for the program, a resolution team of IRS, Chief Counsel, and Treasury personnel is assembled to gather and analyze relevant information for the issue and develop and recommend guidance. Rev. Proc. 2016-19.
 - B. Selected IIR Program requests may result in published guidance, such as a regulation, revenue ruling, revenue procedure, or notice. Alternatively, selected requests may result in new or revised administrative procedures such as an LB&I Operating Division directive or a revision to an Internal Revenue Manual provision.
43. Partnership Audit Procedures
 - A. Pre-2018 TEFRA Partnership Audit Provisions – Code §§ 6221-6234
 - i. Partnership items reported on a taxpayer's return may be separately examined at the partnership level.
 - ii. Special rules govern notification to partners, partner participation in the audit, assessments against partners, and judicial review of the proposed adjustments.
 - iii. The tax matters partner (TMP) represents the partners as the contact person with the IRS. Treas. Reg. § 301.6223(g)-1.
 - iv. Under TEFRA, a district court has jurisdiction in a partnership-level proceeding to determine on a provisional basis whether penalties apply if any partnership item is adjusted. However, to impose the penalties, a separate proceeding at the partner-level is required. Partners could each

raise defenses in partner-level proceedings. *See United States v. Woods*, 134 S. Ct. 557 (2013).

- B. Post-2017 Partnership Audit Procedures
 - i. The new rules replace the TEFRA partnership audit provisions. Code § 6221. They are effective as of 2018, with limited early application and opt out rules.
 - ii. The IRS will audit partnership items at the partnership level for a particular year (called the “reviewed year”). Any adjustments to those items will be made at the partnership level and any resulting tax will be assessed and collected at the partnership level, based on the highest statutory rate (unless a lower tax rate can be demonstrated).
 - iii. Alternatively, the partnership can avoid paying the tax by issuing statements to reviewed-year partners seeking payment of each partner’s share of the increased tax.

Are there Special Exam Procedures for International Tax Controversies?

44. Mutual Agreement Procedure (MAP)

- A. MAP is a treaty procedure by which a taxpayer may request that the IRS and a foreign country tax authority agree on the resolution of tax controversies in a manner that avoids double taxation. Rev. Proc. 2015-40; I.R.M. § 4.60.2.
- B. If a potential double taxation issue is raised by Exam, Exam must notify the taxpayer of its right to seek MAP consideration. I.R.M. § 4.60.2.1.1.
- C. A taxpayer may submit a MAP request after the amount of a proposed adjustment is communicated in writing to the taxpayer (e.g., by a NOPA (see below)). Where a U.S. initiated adjustment has not yet been communicated in writing to the taxpayer, the U.S. competent authority generally will deny the MAP request as premature. Rev. Proc. 2015-40, § 3.04(3).
- D. When the MAP request is accepted, the IRS will postpone further administrative action with respect to the MAP issues, except in specified instances. Rev. Proc. 2015-40, § 6.03; I.R.M. § 4.60.2.3.
- E. If there are other non-MAP issues raised during the examination and the taxpayer is not in agreement with those issues, the usual procedures for completing the examination with respect to the non-MAP issues apply. If the taxpayer is issued a NOPA with respect to the non-MAP issues and protests the issues to IRS Appeals,

the normal IRS Appeals procedures will apply to the non-MAP issues (see below). Rev. Proc. 2015-40, §§ 6.03 & 6.04(3)(a).

- F. The U.S. Competent Authority in its discretion may accept a taxpayer's competent authority request even if the taxpayer previously signed with Exam a Form 870 or Form 870-AD. For a Form 870-AD settlement, however, if the U.S. Competent Authority accepts the taxpayer's request, the U.S. Competent Authority will only attempt to obtain a correlative adjustment from the applicable treaty country. Rev. Proc. 2015-40, § 6.03(1) & (2).
- G. The U.S. Competent Authority in its discretion may accept a taxpayer's competent authority request even if the taxpayer previously pursued resolution of its competent authority issue through an alternative dispute process under the jurisdiction of Exam (e.g., Fast Track Settlement) but will not accept a request where settlement was previously pursued under an alternative dispute process under the jurisdiction of Appeals. Rev. Proc. 2015-40, § 6.03(3).

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

- 45. 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. 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?

- 46. Exam is said to have limited ability to settle issues.
 - A. Generally, Exam does not have authority to settle legal issues based on a hazards of litigation assessment.

- B. On the other hand, Exam does have the ability to raise or not raise issues depending on legal interpretations and factual determinations. In practice, this ability effectively gives Exam some leeway to “settle” issues. I.R.M. § 4.46.
- C. In an LB&I examination, if an issue previously was settled by Appeals, Exam is authorized to settle the issue 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 coordinated issue, on which Appeals has established written settlement guidelines, Exam is authorized to settle the issue according to the guidelines. Delegation Order 4-25; I.R.M. § 4.46.5.6.

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

- 47. Requests for Technical Advice.
 - A. Either the taxpayer or Exam 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). Rev. Proc. 2018-1.
 - 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 Exam team is largely cut out of the discussion.
 - C. If Exam will not recognize that the position it is asserting is incorrect, the taxpayer can seek to request technical advice. When challenged, Exam may drop the issue. Or, when the request is made, the National Office may reject Exam’s position.
 - D. The taxpayer makes a written submission on the facts and applicable law, and will have a conference with the National Office.
 - E. Exam will follow the technical advice that it receives. At Appeals, an unfavorable TAM will not foreclose settlement possibilities.
 - F. A TAM may be used to seek revocation or modification of an earlier TAM or revocation or modification of a private letter ruling (PLR).
- 48. The taxpayer and Exam can seek to resolve certain audit issues under a Fast Track Settlement process. Rev. Proc. 2003-40.

- A. The IRS established Fast Track Dispute Resolution as a pilot program in 2002 and later made the program permanent for large taxpayers on April 4, 2003. IRS News Release IR-2003-44; Rev. Proc. 2003-40.
 - i. Fast Track has been expanded to Tax Exempt and Governmental Entities taxpayers and Small Business/Self Employed taxpayers. IRS Announcement 2008-105; IRS Announcement 2011-5; Rev. Proc. 2017-25.
 - B. In Fast Track Settlement, the Appeals Officer acts like a mediator and helps the parties resolve factual or legal issues. If agreement is reached, the Appeals Officer 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 issue eligibility criteria, the application process, and the settlement process. *See also* I.R.M. § 4.51.4 and Publication 4539.
 - C. Applications for Fast Track are submitted on Form 14017.
 - D. Issues must be fully developed, and the taxpayer must state its position in writing.
 - E. Agreements are reflected in closing agreements. If no agreement is reached, the Fast Track issues can be protested later to Appeals.
 - F. 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.
 - G. The IRS website has information on fast track:
<http://www.irs.gov/Businesses/Fast-Track-Settlement>.
49. Early Referral to IRS Appeals
- A. Large taxpayers can ask Exam to refer developed, unagreed issues to Appeals, while Exam continues 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. If early referral negotiations are unsuccessful and an agreement is not reached with respect to an early referral issue, the taxpayer may then request Appeals mediation for the issue, provided the early referral issue meets the requirements for mediation. *See* IRS Announcement 98-99 (discussed below).

- 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 at <http://www.irs.gov/Businesses/Early-Referral-to-Appeals>.

What Other Special Programs May Apply at Exam?

- 50. In the examination of the tax years under audit, 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.
 - B. Although 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.
- 51. 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.

If the Issue is not Settled, Will the Things I Say in Settlement Discussions Come Back to Haunt Me?

- 52. 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. v. United States*, 250 F. Supp. 2d 748 (E.D. Mich. 2003).

What Does it Mean If My Case Has Been “Designated for Litigation”?

53. Designation for Litigation

- A. If the IRS determines that your case involves an issue that has industry-wide and compliance significance, it may “designate” your case for litigation. This means that the IRS will not settle the issue, but intends to pursue litigation in order to establish a legal precedent. Once designated, settlement can occur only with a full taxpayer concession. I.R.M. § 33.3.6.1.
- B. Taxpayers can contend that their case should not be designated for litigation.
- C. If Exam recommends designation, its recommendation will go to area counsel. The taxpayer has the opportunity to meet with area counsel and the head of the operating division, typically the director of practice. Those individuals send their recommendation to LB&I division counsel, who shares the recommendation with the operating division executive. Again, the taxpayer is able to meet and discuss the recommendation. If affirmed, the recommendation is forwarded to the chief counsel, and the taxpayer has an opportunity for a third meeting. I.R.M. § 33.3.6.2.
- D. If the case is designated, the taxpayer will be issued a statutory notice of deficiency. Although this permits the taxpayer to file a petition with the Tax Court, the taxpayer has the option to pay the tax, file a refund claim, and file a refund action (see discussion below). I.R.M. § 33.3.6.5.
- E. Any case docketed in the Tax Court that has been designated for litigation will not be referred to IRS Appeals. Rev. Proc. 2016-22.

What Will the Agents Do to Conclude the Examination Process?

54. Issuance of a Statutory Notice of Deficiency

- A. Code § 6212 says that if Exam 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.

Steptoe

- C. Exam usually does not end the examination process by issuing a statutory notice, but may do so if the taxpayer refuses to extend the statute of limitations on assessment.
55. Issuance of the 30-Day Letter and Revenue Agent's Report (RAR)
- A. Normally, Exam will issue a 30-day letter, which transmits a RAR containing Exam's proposed adjustments.
 - B. 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.
 - C. 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 Appeals.
 - i. Protest procedures are discussed below.
56. 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).
- A. The taxpayer can make a payment to stop the running of interest.
 - B. 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?

- I. 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. By executing a Form 870, 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.

Steptoe

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 date 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 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. Large taxpayers formerly received automatic 60-day extensions, but now extensions beyond 30 days must be specifically requested.

What is the IRS Collection Process?

57. IRS Publication 594 explains the IRS collection process.
- A. The publication discusses taxpayers in bankruptcy, taxpayers wanting to enter into an installment payment agreement, and taxpayers who seek to make an offer in compromise.
 - B. A collection due process hearing is available for taxpayers who receive a notice of intent to levy, a notice of federal tax lien filing, or other collection notices. See Form 12153.
 - C. Thereafter, the collection IRS Appeals program affords taxpayers a right to appeal. See Publication 160 and Form 9423.

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

58. A concern shared by many taxpayers is whether Appeals actually gives the taxpayer a fair, impartial, and independent hearing.
- A. Appeals has stated that it will remain independent of the LB&I issue campaign program, which targets specific issues and controls outcomes (see above).
 - B. From time-to-time Appeals issues various statements touting its independence from Exam's influence. In 2012, Appeals announced its Appeals Judicial Approach and Culture (AJAC) program. Aside from its claim of independence, this program restricts taxpayers' ability to present to Appeals new information not presented to Exam.
 - C. Nevertheless, doubts remain. If a taxpayer has a "one off" issue, Appeals is more likely to be independent. Taxpayers with "industry issues," however, may be subject to predetermined resolutions.
 - D. See Rev. Proc. 2016-22 regarding the Appeals process for cases docketed in the Tax Court.
 - E. Note that to go to Appeals the taxpayer likely will need to extend the statute of limitations on assessment. Form 872.
59. Filing a Protest and Going to IRS Appeals
- A. The decision to protest or not to protest
 - i. Why protest?
 - (1) 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.
 - (2) You keep open your options to proceed to all litigation forums (see below).
 - (3) You can delay payment of proposed tax increases. Hot interest, however, begins to accumulate after the 30-day letter.
 - (4) You can learn more about the IRS's position, continue to develop your facts, and refine your own arguments.
 - ii. Why not protest?

- (1) 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.
 - (2) You may not want to give the IRS more time to develop its position.
- B. What if I don't protest to Appeals, receive a statutory notice, and file a Tax Court petition?
- i. Usually, unless Appeals issued the notice of deficiency or made the determination that is the basis of the Tax Court's jurisdiction, once the case is filed in the Tax Court, it will be referred back to Appeals. Notice 2016-222, updating Notice 2015-72 and superseding Rev. Proc. 87-24.
 - ii. This procedure may be beneficial if Exam seeks long statute extensions that delay the taxpayer's access to Appeals. The taxpayer can refuse to extend the statute and force Exam to issue a statutory notice. The cost of getting this access to Appeals is filing a Tax Court petition. See Choice of Forum, below.
 - iii. Appeals may exclude IRS counsel from participation in the settlement conference. However, Appeals' settlement authority is restricted if the case has been designated for litigation or if counsel has determined that referral to Appeals is not in the interest of sound tax administration.

What Are the Procedures for Filing a Protest?

60. Contents of the Protest

- A. The IRS specifies the required form and contents of the protest. Publication 5.
 - i. Taxpayers can file either a full or a skeletal protest. If the taxpayer is serious about settlement, a full protest is desirable.
 - ii. Taxpayers can raise affirmative issues in the protest. I.R.M. § 8.6.1.6.4.
- B. The taxpayer must sign a verification, under penalties of perjury, attesting to the facts set forth in the protest.
- C. The taxpayer's representative should attach a Form 2848, Power of Attorney.

61. After filing the protest, when will Appeals contact me?

- A. Appeals typically will contact you within 60 days, although the response time will vary depending on the complexity of the facts and issues.

- B. If you have not heard from Appeals within 120 days, you can either contact Exam and request that Exam contact Appeals and request an explanation for the delay or call the Appeals Account Resolution Specialist (AARS) at 559.233.1267. The AARS will tell you if your case has been assigned to an Appeals employee and how to contact that employee directly.

Can Exam Respond to My Protest? Can Exam Talk to Appeals and “Poison the Well”?

- 62. Exam will file a Rebuttal to the protest
 - A. Exam receives a copy of the protest, and will prepare a written rebuttal supporting its proposed RAR adjustments.
 - B. Exam will comment on both legal and factual issues raised by the taxpayer in the protest.
 - C. Formerly, Appeals Officers would meet with Exam, 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.
 - D. At the Ex Parte conference, the taxpayer need not passively listen to Exam’s presentation. The taxpayer should consider making a fact and legal presentation first, before Exam does. Also, during Exam’s presentation the taxpayer can voice the concern that Exam’s facts and legal analysis are erroneous or incomplete.
 - E. Once Exam has made its presentation, the former rule was that Exam should exit the Ex Parte conference and that Exam should not be present when the taxpayer and Appeals discuss the issues and potential resolutions. As discussed below, this rule, and the independence of Appeals, is eroding.

Can Appeals Ask Me for Extensions of the Assessment Period?

- 63. Appeals may and probably will ask for extensions of the period for assessment
 - A. Extensions can be effected using Form 872, which extend the assessment period to a specified date.
 - B. Extensions also can be made using Form 872-A, which are open-ended extensions. Open-ended extensions are terminated using Form 872-T.

- i. Open-ended extensions usually should not be used. Form 872 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?

64. Composition of the Appeals team
 - A. Smaller cases may have a single Appeals Officer.
 - B. Larger cases will have an Appeals team, composed of an Appeals Team Case Leader and one or more Appeals Officers. I.R.M § 8.7.11.
65. Ex Parte rules and Exam's participation at Appeals Conferences
 - A. Ex parte communications are communications, both oral and written, other than purely ministerial communications, between the Appeals Officer and any other IRS employee, without participation by the taxpayer, in which the merits of issues are discussed. I.R.M. §§ 8.1.10.1.5 and 8.1.10.4.1. If the taxpayer is given the opportunity to participate, but chooses not to, the communication is not ex parte. I.R.M. §§ 8.1.10.2 and 8.1.10.5.
 - B. 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; I.R.M. § 8.1.10.4.
 - C. 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.
 - D. If communications with the originating function extend beyond ministerial, administrative, or procedural matters and the substance of the issues in the case is addressed, those communications are prohibited unless the taxpayer or the taxpayer's representative is given an opportunity to participate.
 - E. Appeals may obtain legal advice from the Office of Chief Counsel, and Chief Counsel attorneys may be invited to participate in conferences. Appeals is not bound by that legal advice and remains ultimately responsible for independently evaluating the strengths and weaknesses of the issues and making independent judgments concerning the hazards of litigation. Rev. Proc. 2012-18.
 - F. Appeals may have a case that is related to a case docketed in Tax Court. In such a case, Appeals must coordinate settlement with Area Counsel and receive Counsel

approval of settlement terms. Communications between Appeals and Counsel will not be ex parte communications. CCA 2015040016 (Jan. 2015).

66. Attendance at Appeals conferences

- A. If complicated technical issues are present, Appeals may initiate Pre-Planning Conference Contacts with Exam. The ex parte rules require that the taxpayer be offered the opportunity to participate. I.R.M. § 8.7.11.7.3.
- B. Typically (and in all LB&I cases, Appeals will schedule a Pre-Conference Meeting (formerly called an ex parte meeting). The purpose of this meeting is to have a discussion between Exam, Appeals, and the taxpayer regarding the issues, the protest, and Exam's rebuttal. I.R.M. § 8.7.11.8.1.
- C. A May 2017 Appeals initiative calls for Exam representatives to participate in Appeals conferences. The purpose is to make Exam attendance routine.
 - i. The IRS states that this initiative reflects existing practice and does not violate the ex parte rules because the taxpayer is invited to participate. Rev. Proc. 2012-8, § 2.01(3).
 - ii. The intent is to improve conference efficiency, reach case resolution sooner, and offer certainty for issues in future years. Appeals believes that participation by Exam will ensure a full understanding of any factual disagreements and the parties' legal positions.
 - iii. Although many taxpayers object to Exam's participation, arguing that the initiative changes the Appeals process into a fast-track settlement or a mediation procedure and that Appeals' independence and impartiality are thereby compromised, Appeals asserts that the initiative will enhance public confidence in the integrity and efficiency of the IRS.
 - iv. Appeals states, however, that settlement negotiations will be held between Appeals and the taxpayer without Exam being present.

67. Appeals conference procedures.

- A. Effective October 2016 the IRS revised the IRM to provide that all Appeals conferences should be held by telephone unless the taxpayer requests an in-person conference and the case meets specified criteria. See Fact Sheet, Changes to Case Transfer and Conference Procedures (October 3, 2016); IRM § 8.6.1.4.
- B. Subsequently, in 2017, in the face of negative taxpayer reactions, Appeals reversed course and stated that taxpayers are entitled to an in-person conference if they request one.

- C. Appeals also has offered an alternative, secure, web-based screen sharing virtual conference option. *See* IR-2017-122; <https://www.irs.gov/compliance/appeals/appeals-virtual-conferences-webex>.
- D. Appeals will not raise new issues or reopen issues on which the taxpayer and Exam have reached agreement. If the taxpayer attempts to raise a new issue, Appeals will return the case to Exam to develop the issue and to make a determination (see below).
- E. The taxpayer should consider whether and which of its in-house representatives should attend.
 - i. 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.
 - ii. 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.
- F. Expert consultants may attend conferences. This can be useful when technical issues are involved. An expert's attendance may inform the Appeals Officer about the hazards of litigation.

What Settlement Authority Do the Appeals Officers Have?

- 68. Appeals' ability to settle issues
 - A. 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 and 8.6.1.6.2.
 - i. The IRS began implementing the Appeals Judicial Approach and Culture Project (AJAC) in July 2013, the goal of which is to achieve a "quasi-judicial approach" regarding appeals.
 - ii. AJAC has been removed from the IRS website, but many of its principles remain. I.R.M. § 8.6.
 - iii. As mentioned previously, LB&I is pursuing an issue-based, issue-campaign approach to examinations and has announced compliance campaigns for selected issues. LB&I selects campaign issues based on a risk-based analysis. Appeals asserts that it is not "participating upfront" in

the campaign compliance process. It remains to be seen how the campaign process will affect Appeals' asserted independence.

- B. Appeals should apply a “hazards of litigation” standard in considering settlement of issues.
 - i. Such a settlement can involve mutual concessions on a single issue. Policy Statement P-8-47; I.R.M. § 8.6.4.1.1.
 - ii. 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.
 - C. 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.
69. Appeals generally will not return a case to Exam for factual development, but will attempt to settle the case with the information in hand. I.R.M. § 8.6.1.6.2(2).
- A. If the facts were not fully developed by Exam, Appeals will settle the case based on factual hazards considering only the developed facts (and will not attempt to develop new facts), so long as the taxpayer has presented no new information.
70. Appeals will return the case to Exam, or consult Exam, in certain circumstances. Interim I.R.M. § 8.2.1.5.
- A. Appeals will return the case to Exam if the protest fails to set forth the taxpayer's position, lacks detail, or fails to meet the requirements of Publication 5 or if Appeals discovers potential fraud, malfeasance, or misrepresentation of a material fact.
 - B. If, with respect to an issue examined and protested, the taxpayer provides new information or evidence not provided to Exam, Appeals will return the issue to Exam. The new information must merit additional analysis or investigative action by Exam. I.R.M. § 8.6.1.6.5.
 - C. If the taxpayer raises a new issue, Appeals will engage Exam for review and comment. I.R.M. § 8.6.1.6.4.
71. Appeals' ability to raise “New Issues”
- A. Appeals consideration is not a continuation of the examination. New issues, and issues agreed with Exam, will not be raised, or threatened to be raised, for bargaining purposes (except in case of fraud, misrepresentation, or malfeasance).
 - i. Previously, Appeals was permitted to raise a new issue if the issue was substantial and the potential effect upon the tax liability was material.

- ii. Currently, Appeals will not raise new issues and will not reopen an issue on which the taxpayer and the Service are in agreement. Policy Statement 8-2; I.R.M. § 8.6.1.6.
 - iii. For purposes of the restriction on raising new issues, new issues do not include issues raised by taxpayers or issues recommended to be raised by IRS counsel in the course of reviewing a statutory notice of deficiency prior to its issuance. I.R.M. § 8.6.1.6.1.
 - iv. Both Appeals and the taxpayer can cite new cases or rulings, and can raise new theories and/or legal arguments to support their positions.
 - (1) Appeals cannot develop new evidence that is not in the case to support a new theory or argument. I.R.M. § 8.6.1.6.2(3).
 - (2) If the taxpayer raises the new theory or argument, Appeals will return the case to Exam for its review and comment. I.R.M. § 8.6.1.6.6. In this process, Exam can revisit or raise new issues as it deems appropriate.
72. Appeals can ask for a legal opinion from Field counsel or National Office counsel. I.R.M. § 33.1; Rev. Proc. 2012-18; CCA 201504016 (2015).

Can I Accelerate the Appeals Process?

73. Mutually Accelerated Appeals Process (MAAP)
- A. MAAP is an IRS initiative to reduce the time necessary to resolve cases in Appeals for large taxpayers by adding members to Appeals teams and/or creating new teams. IRS News Release IR-2000-42.
 - B. Taxpayers can ask Appeals for a MAAP agreement, but the effect of the agreement likely is minimal.
74. Rapid Appeals Process (RAP)
- A. RAP is designed to resolve disputed issues in one session by bringing together LB&I, Appeals, and the taxpayer at the pre-opening conference before Appeals. I.R.M. § 8.26.11.1. The case is under the jurisdiction of Appeals, and the Appeals Team Case Leader acts as mediator between Exam and the taxpayer. I.R.M. § 8.26.11.5.
 - i. The program is available for most LB&I cases, including Appeals Coordinated Issues (ACI), Industry Specialization Program (ISP) issues, and listed transactions. I.R.M. § 8.26.11.3. See I.R.M. § 8.26.11.4 for

types of cases excluded from RAP. Ineligibility of one issue in a case does not foreclose the use of RAP for other disputed issues in the case. I.R.M. § 8.26.11.5.

- ii. RAP is well-suited for use when issues are “fully developed and ready for immediate consideration and resolution.” I.R.M. § 8.26.11.2.
 - iii. The taxpayer may be asked to waive restrictions on ex parte communications during RAP (on Form 14525). If RAP is unsuccessful, the waiver is terminated going forward. I.R.M. § 8.26.11.6.
- B. RAP may be terminated by the taxpayer, LB&I, or the Appeals Team Case Leader at any time. In the event that it is not effective, RAP does not foreclose the use of other existing dispute resolution options. I.R.M. § 8.26.11.2.
- C. If RAP proves unsuccessful, any information disclosed may be used by Appeals to evaluate the hazards of litigation. I.R.M. § 8.26.11.6.

Are There Procedures That Restrict an Appeals Officer’s Ability to Settle Cases?

75. Appeals Settlement Guidelines (ASGs)

- A. For certain issues Appeals has developed ASGs.
- i. These are issues of IRS-wide impact or importance that require Appeals’ coordination to ensure uniformity and consistency nationwide. This is achieved through the coordination of efforts between Appeals Officers and designated ASG coordinators. The ASG program encompasses both legal issues and factual issues. I.R.M. § 8.7.3.2.2.
- B. An Appeals Officer assigned to a case with an ASG must consult with the ASG coordinator prior to the scheduling of the initial conference to obtain current information. The coordinator may be assigned as a team member or a consultant on the case.
- C. With ASGs, the Appeals Officer must get review and concurrence from the ASG coordinator prior to discussing the settlement with the taxpayer. Such review and concurrence extends to all aspects of the settlement including closing documents.
- i. This can result in a one-size-fits-all settlement approach, with little consideration given to distinguishing facts.
- D. A current list of the ASGs can be found at <http://www.irs.gov/Individuals/Appeals-Settlement-Guidelines-asg>.

76. Appeals also may identify Appeals Emerging Issues, which have not yet reached the level of having an ASG.
- A. An Appeals Emerging Issue is an issue that has surfaced in an industry or specialty area in a number of Appeals cases or an issue that Appeals expects to appear in cases that will be coming to Appeals in the near future.
 - B. For these issues, review and concurrence of the Technical Specialist is not necessary, but the Appeals Officer is required to remain in contact with the Technical Specialist. I.R.M. § 8.7.3.2.3.

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

77. Technical Advice Requests
- A. The taxpayer or the Appeals Officer can file a request for technical advice with the IRS National Office. Rev. Proc. 2016-2.
 - B. If the TAM favors the taxpayer, Appeals will follow the TAM.
 - C. If the TAM favors the IRS, Appeals still is able to concede or settle the issue, but that will be unlikely.
 - D. Appeals Officers also are able to request more informal legal advice from Field Counsel.
78. Appeals Mediation program. Code § 7123(b)(1).
- A. 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 except for the issues for which mediation is being requested.
 - B. 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 Procedures for Non-Collection Cases).
 - C. An Appeals Officer will be supplied by the IRS as a mediator. The taxpayer may elect a non-IRS co-mediator at its own expense.

- D. The following issues are eligible for mediation: factual issues, legal 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 into a closing agreement (*see* Code § 7121), and offer in compromise and Trust Fund Recovery Penalty cases (*see* IRS Announcement 2011-6).
79. Appeals Arbitration program. Code § 7123(b)(2).
- A. 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 (10/18/2006); 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.
- B. Appeals arbitration was discontinued in 2015, as the IRS announced that only two cases used it successfully. Rev. Proc. 2015-44.

Are there Special Appeals Procedures for International Tax Controversies?

80. The Mutual Agreement Procedure (MAP). Rev. Proc. 2015-40.
- A. MAP is a treaty procedure by which the IRS and a foreign country tax authority agree on the resolution of tax controversies in a manner that avoids double taxation. Rev. Proc. 2015-40; I.R.M. § 4.60.2.
- B. Competent authority issues accepted by the U.S. Competent Authority are not subject to the concurrent jurisdiction of Appeals. Rev. Proc. 2015-40, § 6.04(1).
- C. A taxpayer that pursues competent authority issues in Appeals, or an alternative dispute resolution under the jurisdiction of Appeals, rather than filing a request for assistance with the U.S. Competent Authority will lose its ability to obtain future competent authority assistance and may also adversely affect the availability of its foreign tax credits. A taxpayer that “protests” a competent authority issue to Appeals can obtain access to competent authority assistance if it severs the competent authority issue from its Appeals protest and files a request for competent authority assistance no later than 60 days after its opening conference with Appeals. Rev. Proc. 2015-40, § 6.04(3).
- D. A taxpayer that files a request for competent authority assistance may obtain subsequent Appeals review of the competent authority issue, however, if the U.S. Competent Authority rejects the taxpayer’s request for assistance or otherwise terminates the process, or the Competent Authorities do not reach an agreement

on the issue or the taxpayer rejects the agreement that is reached by the Competent Authorities. Rev. Proc. 2015-40, § 6.04(4).

- E. A taxpayer filing for competent authority assistance may request Simultaneous Appeals Procedure (SAP) review. It is within the sole discretion of the U.S. Competent Authority whether to accept the taxpayer's SAP request, and the U.S. Competent Authority determines on a case-by-case basis the manner in which the SAP review is conducted. Under the SAP review, Appeals works jointly with the U.S. Competent Authority and the taxpayer to facilitate the U.S. Competent Authority's unilateral consideration of the resolution of the competent authority issue before the U.S. Competent Authority presents its position to the foreign competent authority. Rev. Proc. 2015-40, § 6.04(2).
81. OECD BEPS Action 14 may lead to other dispute resolution mechanisms for international tax controversies.

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

82. Conclusion of the Appeals process
- A. A resolution of issues at Appeals can be effected through a closing agreement. Code § 7121; Form 906.
 - i. 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.
 - B. 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.
 - i. A Form 870-AD waives the restrictions on assessment and allows the IRS to assess the tax agreed to. Although a Form 870-AD agreement does not have the same finality as a closing agreement, the form contains a pledge by the IRS and the taxpayer not to reopen the case once the agreement is executed.
 - ii. The Supreme Court has held that closing agreements are the "exclusive method" for compromising tax liability, stating that Congress "did not intend to intrust [sic] the final settlement of such matters to the informal action of subordinate officials in the" IRS. As a result, informal 870-AD settlements are not legally binding on either the taxpayer or the

government. *Botany Worsted Mills v. United States*, 278 U.S. 282, 288-89 (1929).

- iii. However, the Court went on to note that it was not “determining whether such an agreement, though not binding in itself, may when executed become, under some circumstances, binding on the parties by estoppel.” *Id.* at 289.
 - iv. In the years since *Botany Worsted*, a number of courts of appeals have determined that informal settlements such as Form 870-AD can create estoppel against taxpayers, although there is disagreement as to when, if ever, estoppel may apply. *See Whitney v. United States*, 826 F.2d 896, 897-98 (9th Cir. 1987) (citing cases).
 - v. It does not appear that any circuit has used an informal tax settlement to bind the IRS under estoppel principles. *See Shafmaster v. United States*, 707 F.3d 130 (1st Cir. 2013).
- C. 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.

What Do I Do If I Want to Finally Resolve the Case by Settling All of the Issues (Option #1)?

83. Option #1 – Totally agreed case
- A. Compute the deficiency or overassessment due based on the resolution of the issues, and reflect that amount on Form 870-AD.
 - B. 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.
 - C. The Form 870-AD contains a pledge by both parties not to reopen the case and is intended to have binding effect on both parties (see discussion in the prior section).
 - D. If the settled 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.
 - E. If the settlement reached has effects in subsequent years, it may be desirable to execute a closing agreement. I.R.M. §§ 8.6.4.1.8(2) and 8.6.4.3.3.

What Do I Do If I Want to Settle Some Issues, But Also Want to Take Other Issues into Refund Litigation (Option #2)?

84. Option #2 – Partially agreed case, with unagreed issues reserved for litigation in district court or the Court of Federal Claims. This typically is referred to as a “Settlement with Reservations.”
- A. 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.
 - B. 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).
 - C. 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.
 - D. Thereafter, the taxpayer must file a timely claim for refund based on the issues reserved for litigation. (See below.)
 - E. If the taxpayer fails to reserve an issue, the taxpayer may not be able raise (i.e., reopen) the issue in the claim for refund. (See equitable estoppel, above.)
 - F. If the government fails to reserve an issue, the government may not be able to raise the issue, except as an offset in the refund litigation. (See equitable estoppel, above.)

What Do I Do If I Want to Settle Some Issues, But Also Want to Take Other Issues into the Tax Court (Option #3)?

85. Option #3 – Partially agreed case, with unagreed issues left for litigation in the Tax Court. This typically is referred to as a “Partial Agreement.”
- A. 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.
 - B. Execute Form 870-AD reflecting the agreed deficiency, listing the issues that have been settled. I.R.M. § 8.6.4.4.1.

- C. 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.
- D. The IRS will issue a statutory notice of deficiency seeking the tax due with respect to the unagreed issues.
- E. 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 taxpayer can raise new issues in its Tax Court petition. The IRS can raise any unsettled issue in the Tax Court as a "new matter." Tax Court Rule 142.
- F. 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?**

86. 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.
 - i. 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).
 - ii. 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.
 - iii. 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).
 - iv. The "equitable tolling" doctrine does not apply to the Code § 6511 time restrictions. *United States v. Brockamp*, 519 U.S. 347 (1997).
- C. Contents of the refund claim
 - i. The claim is filed using Form 1120X.

- ii. Each issue must be adequately described in the refund claim. Enough information must be provided to describe adequately the issue to the IRS. Treas. Reg. §§ 301.6402-2 and 301.6402-3.

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

- 87. 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.
 - A. As discussed above, 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.
- 88. 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).
 - A. Therefore, it is critical to raise in the refund claim all of the issues that you want to litigate.
 - B. Be careful to consider whether raising an issue will have collateral tax effects. If so, those tax effects should be claimed as well. (*E.g.*, if an issue impacts credits or NOLs.)
- 89. 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. 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 Actions Can the IRS Take Regarding the Refund Claim?

- 90. Possible IRS actions on the claim
 - A. The IRS can allow or disallow the claim, in part or in whole, or can simply not act on the refund claim.
 - B. 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.

- C. The IRS may send the taxpayer a notice of proposed disallowance of the refund claim. The taxpayer can protest the proposed disallowance to Appeals.
 - i. 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.
- D. 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.

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

- 91. The statute of limitations for filing the refund litigation
 - A. The refund suit can be filed immediately after the disallowance, and must be filed within two years of the date of mailing of the formal notice of claim disallowance.
 - B. 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. Best practice is to use the date that the taxpayer signs and dates the form.
 - C. 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, When Can I File the Refund Suit?

- 92. Ability to commence the refund litigation
 - A. 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).
 - B. If the taxpayer executed Form 2297, the taxpayer also must wait 6 months to file suit.

- C. 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).
- D. If the IRS fails to disallow the refund claim, the common view is that the two-year limitations period for filing suit does not begin to run. I.R.M. § 34.5.2.2 provides that the “statute of limitations does not begin to run until the Service issues a notice of claim disallowance.”
 - i. I.R.M. § 34.5.2.2 provides that “the general six-year period of limitation for bringing claims against the government in 28 U.S.C. §§ 2401 and 2501 does not apply to tax refund suits.” Some disagree with this view, however. *Gustafson, Adam, “An ‘Outside Limit’ for Refund Suits: The Case Against the Tax Exception to the Six-Year Bar on Claims Against the Government” (2011), Student Scholarship Papers, Paper 111.*
 - ii. After some time period, however, the government may claim that the equitable principle of laches applies. To invoke laches, a defendant “must show that plaintiffs unreasonably delayed in bringing suit and that [defendants] were prejudiced by this delay; the mere lapse of time does not constitute laches.” *Environmental Defense Fund v. Tennessee Valley Auth.*, 468 F.2d 1164, 1182 (6th Cir. 1972).

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

- 93. 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, What Are Some Important Issues that I Should Consider?

94. Should I litigate in the Tax Court?
- A. Litigating in the Tax Court does not require payment of the tax deficiency. Hot interest, however, will continue to accrue. Once the petition has been filed, however, the taxpayer can pay the tax to stop the running of interest.
 - B. Tax Court litigation can be initiated quickly. Indeed, the petition must be filed within 90 days of the statutory notice.
 - C. What is the applicable precedent in the Tax Court?
 - D. 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.
 - E. Consider the tax background, tax experience, and tax 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.”
 - F. 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”?
 - G. Your opposing counsel will be an IRS attorney from IRS District Counsel’s office. This might mean the IRS will give more deference to the IRS position and be less inclined to settle.
 - H. If a case was not considered previously at IRS Appeals, the case is likely to be referred back to Appeals for settlement discussions. Rev. Proc. 2016-22.
 - i. Counsel will refer docketed cases to Appeals for settlement consideration unless (1) Appeals issued the notice of deficiency or made the determination that is the basis of the Tax Court’s jurisdiction or (2) the taxpayer notifies Counsel that the taxpayer wants to forego settlement consideration by Appeals.
 - ii. Rev. Proc. 2016-22 addresses the timing and mechanics of referral between Counsel and Appeals.
 - I. The Tax Court’s rules of procedure will apply.

- i. The Tax Court has somewhat limited discovery procedures available for the parties.
 - ii. In the Tax Court, the parties must stipulate to facts to the extent possible.
 - iii. In the Tax Court, trial will be to a judge, who will decide the case; jury trials are not available.
95. 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 litigation 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.

**In Choosing Whether to Litigate in Refund Litigation,
What Are Some Important Issues that I Should Consider?**

96. Should I choose refund litigation?
- A. To initiate refund litigation, the taxpayer must pay the asserted tax, penalties, and interest in full.
 - B. Because the taxpayer must file a claim for refund, filing suit will be delayed for some period of time, unless the IRS agrees to immediately disallow the claim.
97. In refund litigation, if the period of limitations is closed, the government can raise new issues only as “offsets.”
- A. The government has no restrictions on its ability to raise new issues in its answer to the taxpayer’s complaint.
 - B. There is uncertainty regarding the pleading standard the government must meet when raising additional tax liabilities as an affirmative defense in a refund suit. Appellate courts have yet to weigh in on whether a plausibility standard applies that would require the government’s affirmative defenses to be facially plausible. One view is that the government does not have to satisfy the plausibility standard

in its pleading. *See Lockheed Martin Corp. v. United States*, 973 F. Supp. 2d 591 (D. Md. 2013).

- C. However, there is a significant restriction on the government’s 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. Furthermore, the government is generally limited to offsetting deficiencies from one tax year against overpayments in the same tax year. One exception, allowing the government to net deficiencies and overpayments over a number of tax years, is when the taxpayer has entered into a closing agreement with the IRS that covers multiple tax years. *See El Paso CGP Co. v. United States*, 748 F.3d 225 (5th Cir. 2014).
 - D. For an example of offsetting, 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.)
 - E. On these offset issues, the taxpayer has the burden of proof.
98. 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 in Washington, DC. This is a court with national jurisdiction, available to all taxpayers, wherever located.

**In Choosing Whether to Litigate in District Court,
What Are Some Important Issues that I Should Consider?**

99. Litigation in District Court
- A. What is the applicable precedent in the district?

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- 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. This attorney may assess the IRS's position more independently and be more inclined to settle.
- G. The Federal Rules of Civil Procedure will apply.
- H. Discovery rules allow more discovery than is permitted in the Tax Court.

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

100. 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 full-on 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. This attorney may assess the IRS's position more independently and be more inclined to settle.
- F. The Rules of the Court of Federal Claims apply. These rules differ slightly from, but are generally similar to, the Federal Rules of Civil Procedure.

**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.**

- 101. 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.
- 102. 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.
- 103. 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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Bios of Steptoe Tax Controversy and Litigation Attorneys

Pat Derdenger is a tax partner in Steptoe's Phoenix office. His practice emphasizes federal, state, and local taxation law. (Mr. Derdenger is certified as a tax law specialist by the Arizona State Bar.) Mr. Derdenger has been listed in *The Best Lawyers in America* since 1995 and has been listed in *Southwest Super Lawyers* for State, Local, and Federal Taxation since 2007. Mr. Derdenger provides advice and representation on income tax matters, employment tax matters, independent contractor/employee issues, responsible officer penalties, information return filing penalties, and excise taxes, the transportation excise tax and the communications excise tax. Mr. Derdenger has extensive experience in advising clients on various employment tax and independent contractor issues, including the treatment of "leased employees" for employment tax purposes. He also represents business clients in tax controversy matters, income, employment, and excise taxes with the Internal Revenue Service at the audit, appeals, and court levels, including the US Tax Court.

Walker Johnson is a tax partner in Steptoe's Washington, D.C. office. From 1978 to 1984 Mr. Johnson was a trial attorney in the Tax Division, U.S. Department of Justice, where he litigated numerous tax cases. Since 1987 he has been an adjunct law professor in the Graduate Tax LL.M. Program at the Georgetown University Law Center, presenting a course on the Taxation of Financial Institutions and Products. At Steptoe, he has litigated numerous major tax cases, including cases such as *New York Life* (payment vs. deposit), *American Electric Power* (COLI policies), *Textron* (tax accrual workpapers), *John Hancock* (cross-border leveraged leasing), and others. He is recognized as a leading tax litigator by *Chambers*, *Legal 500*, and *Best Lawyers in America*.

Greg Kidder is a tax partner in Steptoe's Washington office. His practice focuses on federal income taxation issues, with particular emphasis on the taxation of corporate entities and cross-border transactions. Mr. Kidder advises clients on structuring corporate transactions, including mergers, acquisitions, and spin-off transactions for large public corporations, as well as closely held businesses. He also advises clients on international issues, including deferral, foreign tax credits, and tax treaty matters. In addition to providing tax planning advice, Mr. Kidder also assists clients in tax controversy matters, including all stages of the Internal Revenue Service administrative process and in litigation. He has extensive experience negotiating with field agents, Appeals Officers, and district counsel in settling significant audit issues.

Robert Rizzi is a tax partner in Steptoe's Washington and New York offices. His practice emphasizes federal and state income tax aspects of corporate partnership business transactions, including mergers and acquisitions, reorganizations, work outs, and joint ventures, and advice to high net-worth families on transactional and cross-border matters. Mr. Rizzi has experience in tax planning for transactions in the financial services, telecom, real estate, technology, and hospitality sectors, primarily in international markets. He also provides tax advice and structuring for mid-market and private equity transactions in the United States and abroad. Mr. Rizzi also represents prospective political appointees requiring Senate confirmation

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through the vetting process. Mr. Rizzi teaches government ethics at Harvard Law School, and has taught at Catholic University Law School and the Georgetown University Law Center.

Philip R. West is the chairman of Steptoe and head of the Tax Group, where his practice is focused mainly on international tax issues for both domestic and foreign clients. With more than 25 years in both private practice and government service, he has extensive practical experience minimizing the tax cost of international business operations and transactions, persuading decision-makers, and resolving tax controversies. Mr. West has deep substantive knowledge of income deferral, foreign tax credit, transfer pricing, FATCA, and tax treaty matters; as well as of the tax aspects of mergers, acquisitions, joint ventures, financings, investment funds, and tax minimization structures and transactions. Mr. West has been consistently effective in advocacy before the IRS, Treasury Department, and Congress on both technical matters and issues of broad policy significance. Mr. West is regularly consulted and cited by government officials and the news media. For example, he recently testified before Congress, has advised numerous tax administrations around the world, and is often quoted by media outlets including *The Wall Street Journal*, *Bloomberg*, and many other publications. Mr. West speaks regularly to professional and academic audiences and has published widely on international tax and other matters.