Internal Revenue Service Circular 230 Disclosure: As provided for in Treasury regulations, advice (if any) relating to federal taxes that is contained in this communication is not intended or written to be used, and cannot be used, for the purpose of (1) avoiding penalties under the Internal Revenue Code or (2) promoting, marketing or recommending to another party any plan or arrangement addressed herein.
The Exam
Introduction and Key Concepts
What Should You Do at the Beginning of the Audit?

- Develop a working relationship with your examination team
  - Set procedural ground rules for access to documents, use of company facilities, etc.
  - Get to know your examiners on a personal basis
- Establish ground rules for the structure of the audit
  - Select a primary contact for the examination team to work through
  - Negotiate scope of the audit
    - Investigate whether a Limited Issue Focused Examination (LIFE) is available
    - Discuss parameters for the number of Information Document Requests (IDRs) and employee interviews
  - Negotiate timing of the audit
    - Discuss time parameters for completing the audit, extending the statute of limitations
What Should You Do During the Course of the Audit?

- Consider presenting potentially significant issues to Exam up front
  - Establishes good and trusting relationship with Exam
  - Allows opportunity to set tone and primary considerations for resolution of the issues

- Proactive steps to optimize success on outstanding issues with Exam
  - Provide positive documents to the examination team up front, potentially limiting broader future requests.
  - Be cooperative, but not to your detriment.
    - Do not volunteer witnesses for interviews unless requested.
    - Limit your responses to IDR's to the questions asked.
  - Keep the audit on schedule.
    - Do not give the examination team a reason to extend the audit or address additional transactions/issues by not responding timely or completely to IDR's.
    - Stay in contact with the examination team on a regular basis.
What Role Should Outside Counsel Play?

- Assisting in the drafting of IDR responses
- Reviewing documents for privilege or work product protection
- Preparing witnesses for interviews and defending interviews
- Assisting with the drafting of responses to IRS proposed legal conclusions (Form 5701s) and Revenue Agent Reports (RARs)
- Playing the “bad cop” with respect to particular issues that arise during the course of the audit
Basic Exam Procedures
How Does The Service Conduct Field Examinations?

- The Service is authorized by statute to conduct examinations. Code § 7601.

- The time and the place of the examination must be “reasonable under the circumstances.” Code § 7605.

- Revenue agents have broad examination powers, and it is difficult to limit the examination.
Can The Taxpayer Control The Process?

- Taxpayers should ask the Service for an audit plan and a time table.

- Taxpayers should designate persons to whom the Service can direct requests for information, and should ask that the Service submit its requests for information in writing, i.e., by submitting IDRs.
How Much Time Does the Service Have To Audit?

- Section 6501 imposes a period of limitations on the Service’s ability to assess deficiencies.

- Tax deficiencies must be assessed within 3 years after the filing of the return. (Under Code § 6501(c) and (e), some special rules may apply, e.g., in the case of fraud, substantial omissions, etc.)

- Section 6501(c)(4) provides that the assessment period may be extended by agreement. Extensions of the assessment period are made using Form 872. (Special forms may be used in certain cases, e.g., Form 872-F, 872-P, 872-S, etc.)
Do I Have To Agree To An Extension of Time?

- A taxpayer may refuse to extend the assessment period.

- However, the Service is permitted to protect itself by issuing a statutory notice of deficiency that asserts a blanket assessment.

- Taxpayers often extend the assessment period for relatively short time periods, so they can retain some control over timing.

- Alternatively, taxpayers may offer to extend the assessment period only with respect to particular issues.
Dealing with IRS Requests for Information
How Should I Respond To IRS Requests For Information?

- Revenue agents are authorized to examine books and records, and to examine persons. Code § 7602(a)(1). Agents ask for information using Form 4564, Information Document Requests (IDRs).
- If the taxpayer fails to produce the required information or person, the Service may issue an administrative summons. Code § 7602(a)(2).
- Care must be taken to read IRS information requests closely. If a request is ambiguous or incomplete, the taxpayer must consider whether it has options to comply narrowly or broadly, and must weigh the pluses and minuses of those options.
- Care must be taken when an IRS request for information encompasses information and documents that are privileged or protected.
How Should I Respond To IRS Requests For Information?

- The Service can request to interview employees. Sometimes the Service will accept written responses in lieu of an employee interview. This permits the taxpayer to provide a more considered response. If the Service insists on an interview, great care should be exercised.

- 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. Preparation is crucial.

- The Service may record the interview. Alternatively, the examining agents may simply take notes.
Dangers of the Interview as “Deposition”

- The Service can take testimony under oath, and have it transcribed by a court reporter. I.R.C. § 7602(a)(2).
- Such testimony will constitute a “prior statement” that may be used to impeach the witness in later proceedings.
- The interview is effectively the same as a deposition.
- IRS counsel (or the agent) may conduct the questioning.
- The Service may use the interview to:
  - Lock the witness into specific factual testimony
  - Establish that the witness has no recollection of certain facts
- Note that this is occurring very early in the controversy process.
- Whether the interview is recorded or not, there can be serious repercussions for providing false or misleading information.
Ability to Participate in the “Deposition”

- The case law uniformly holds that the taxpayer has no right to attend or participate in the questioning, holding that:

  “Neither taxpayers nor their attorneys have the right to be present when the summoned parties produce records nor to participate actively in such proceedings. Nor does the taxpayer have a right to be present and cross examine witnesses when the IRS agent questions them.”

  *Daffin (4th Cir. 1981)*; *Traynor (10th Cir. 1979)*; *Newman (5th Cir. 1971)*; *Jones (D.C.S.C. 1999)*; *Lamberth (E.D. Va. 1979)*
Ability to Participate in the “Deposition”

- However, the person summoned does have the right to legal counsel, and to the counsel of his choice. IRM 25.5.5.4.2.
- Counsel for the taxpayer may, unless a conflict exists, and after full and complete disclosure, represent the witness. IRM 25.5.5.5.
- The Service calls this a “dual representation.”
- Circular 230 does not prevent attorneys from representing both parties, if there is express consent of the parties after full disclosure.
- The IRM states that dual representation is permitted, unless the attorney seeks to impede or obstruct the interview.
- Obstruction occurs if the attorney makes “frivolous objections,” asserts “frivolous privileges” or otherwise disrupts the interview.
Ability to Participate in the “Deposition”

- Moreover, the IRM states that the person summoned “is permitted to have other persons present during the interview.” IRM 25.5.5.4.8. The person summoned can request the taxpayer’s presence.
  - However, when a witness appears pursuant to a summons and is accompanied by a person (other than the taxpayer) who does not represent the individual witness, the IRS may request that such person be excluded from the interview.
  - Note that the IRM then states that “if the witness refuses to be interviewed if that person is excluded and the person is a designee of the taxpayer within the meaning of IRC 6103(c) and its regulations, the interview will proceed unless the interviewing officer decides that continuing the interview will impede development of the case.” In other words, if the IRS request to exclude the other person is refused, and the other person is a taxpayer designee, then the IRS will continue with the interview with the other person present unless it is determined that doing so will impede the development of the case.
- Obtaining the prior cooperation of the witness thus is essential.
- It is necessary to negotiate with the Service to gain access to each interview.
Obtaining Copies of the Materials and Transcript

- The person summoned has the right to audio (but not video) record the proceeding. The taxpayer could request that this be done.
- The taxpayer could arrange to have the witness represented by other counsel. The witness may consent to have that counsel cooperate with the taxpayer’s attorney. Preparing a joint defense agreement usually is a good practice to keep future communications about the issue between the witness and the taxpayer confidential.
- Otherwise, the taxpayer can request the witness transcripts, under the Freedom of Information Act (FOIA) if necessary.
  - The Service may resist, claiming that, under FOIA Exemption #7, disclosure would interfere with the audit investigation.
  - Whether interference would result depends on the specific facts.
  - The interviewee may raise confidentiality or Privacy Act issues.
Information From Third Parties: The Statutory Framework

- The Service’s examination power is extremely broad. I.R.C. § 7602.
  - Most information is considered “relevant or material.”
  - The Service can issue a summons to any person it “may deem proper.”
  - The Service can obtain documents, and take testimony under oath.
- If the Service wants to contact third parties, it must give “reasonable notice in advance to the taxpayer” that contacts may be made. I.R.C. § 7602(c).
- The taxpayer should send a written request to the Service for a list of third party contacts.
- When issuing a third-party summons, the Service must follow the special procedures set forth in section 7609.
- The taxpayer’s officers and employees are not “third parties.”
Timing of the Notice and Response to the Summons

- When it serves a third-party summons, the Service must notify the taxpayer within 3 days of the service date. I.R.C. § 7609(a).
- The date set for a response to the summons cannot be sooner than 24 days after the date that notice is given to the taxpayer.
- During that period:
  - The summoned party cannot comply with the summons.
  - The Service cannot accept any information sought in the summons.
Challenging the Summons

- No later than 20 days after notice of the summons, the taxpayer may bring suit in District Court to quash the summons. I.R.C. § 7609(b).
  - The summoned party has the right to intervene in that proceeding.
  - During the proceeding, the limitations period for assessment against the taxpayer is suspended.

- If the summoned party fails to respond, the Service may bring suit in District Court to enforce the summons.
  - The taxpayer has the right to intervene in that proceeding.
  - If the taxpayer intervenes, the limitations period for assessment against the taxpayer is suspended.
Joint Defense Agreement

- When the Service has targeted several parties to a transaction, the parties can agree to a joint defense agreement.

- These agreements allow the parties to disclose to each other confidential materials related to matters of common interest without waiving a privilege or protection.
Can I “Settle” Issues With The Examining Agent?

- Revenue agents have limited ability to settle issues.
- Typically, revenue agents do not have authority to settle legal issues based on hazards of litigation assessments. IRM 4.10.7.5.3.1.
- On the other hand, revenue agents do have the ability to raise or not raise issues depending on legal interpretations and factual determinations. In practice, this ability effectively gives revenue agents some leeway to “settle” issues.
- If an issue previously was settled by IRS Appeals, revenue agents are authorized to settle the issue in the examination on the same basis. Delegation Order 236.
- If an issue is a Coordinated issue, on which IRS Appeals has established written settlement guidelines, revenue agents are authorized to settle the issue in the examination according to the guidelines. Delegation Order 4-25.
Requests For Technical Advice

- Either the taxpayer or the revenue agent can ask for guidance from the IRS National Office by means of a Request for Technical Advice. In response, the National Office will issue a Technical Advice Memorandum (TAM) or a Technical Expedited Advice Memorandum (TEAM). Rev. Proc. 2011-2.

- If the revenue agents will not recognize that the position they are asserting is incorrect, the taxpayer can seek to request technical advice. When challenged, the agents may drop the issue. Or, when the request is made, the National Office may reject their position.
Requests For Technical Advice

- Exam and the taxpayer will make written submissions on the facts and applicable law. Disagreements over facts may be noted. The parties may have a conference with the National Office.

- The examining agents will follow the technical advice that they receive.

- The Service has provided for the issuance of expedited technical advice through the use of TEAMs. TEAMs allow the Service to expedite the technical advice process by issuing guidance even when the revenue agent and the taxpayer disagree as to the facts. Any issue eligible for a TAM is also eligible for a TEAM.
Will Unsettled Issues Come Back to Haunt Me?


- To ensure that a settlement communication receives this proper treatment, it should be so labeled.
Special Exam Procedures
Industry Issue Focus Program
Implementation of IIF Program

- Implemented in March 2007 by the Large and Mid-Size Business Division ("LMSB") of the IRS

- Compliance issues are identified, then prioritized/tiered based on their prevalence and level of compliance risk
IIF Program

- Understanding the rationales and goals of the IIF Program and how the program actually works is key to handling successfully a case involving tiered issues
  - Insight into the IRS approach allows you to develop your strategy and defense
  - Understanding the documentation the IRS will demand enables you to retain the appropriate materials
General Goals of IIF Program

- Stated IRS goals include:
  - Consistency in resolution across industry lines
  - Improved currency
  - Increased coverage of non-compliant taxpayers by maximizing limited resources
  - Greater oversight on and accountability for important issues
Development of the Three Tiers

- Issues are classified by the Industry Directors.
- Potential Tier I or Tier II issues are presented to the Compliance Strategy Council for approval.
  - If approved, an issue is assigned to the primary affected industry or another LMSB executive to develop a compliance strategy.
- Tier I issues are examined in monthly meetings to reevaluate their placement.
The Three Tiers

- **Tier I:**
  - High strategic importance
  - Significant impact on one or more industries
  - Two categories:
    - Compliance Issues
    - Shelter Issues
  - IRS says Tier I identification doesn’t necessarily mean “bad” or “shelter” but rather of high importance

- **Tier II**
  - Potentially high non-compliance and/or significant compliance risk

- **Tier III**
  - Generally industry-related
  - Have been identified as issues that should be considered by LMSB teams when conducting risk analysis
  - No issues have been assigned to Tier III to date
Be Proactive

- You need to know whether you may have a tiered issue before your audit.
  - Recognize that agents will be suspicious of packaged products sold by consultants.
  - International tax issues are likely to be scrutinized.
- Understand the facts in IRS guidance and distinguish your facts from the start.
- Your response to initial IDR's may be critical in defining the direction the examiners take.
- Don’t let an agent mistakenly label an issue or transaction as tiered because it has some similarity to a tiered issue.
Develop a Good Relationship With the Agent

- If you cooperate, provide information as requested, and generally keep the audit moving, the agent may use a more favorable tone in his/her report to the issue specialist or issue owner executive.
  - This tone may have a significant impact on the specialist or issue owner’s involvement.
- If one of your audit issues has some similarity to a tiered issue, provide the agent with accurate and complete information to ensure that your issue is not labeled incorrectly.
- Don’t wait until the last second to provide information or to work with the agent—establish a good relationship from the beginning so you can work to “manage” the examination as much as possible.
Understand How the IRS Approaches Your Issue

- Read published guidance: Directives, Settlement Guidelines, Audit Guidelines, Notices, Rulings, Coordinated Issue Papers, Regulations, etc.

- Consider how your case fits in.
  - Do you have better/worse facts?
  - What has the IRS approach to this issue been?
  - What is the IRS record on this issue?
Understand the IRS’s General Litigation Strategy on Tiered Issues

- Anecdotal evidence indicates that the IRS is trying to get the cases with the worst facts into court.
  - The IRS is likely to try to delay or settle cases with better facts early on in an issue’s development so it can develop law with cases with bad facts.
Distinguish Your Facts

- Distinguishing your facts is critical.
  - Be prepared early in your audit to distinguish and defend your facts.

- Consider the facts given in any IRS guidance.
  - May be difficult if guidance is vague and facts given are generic.

- Identify other taxpayers with similar issues and learn about their facts.
  - Try to accelerate the strongest taxpayer’s case.
Work With Taxpayers With Similar Issues

- Learn other taxpayers’ facts.
- Learn how the IRS is approaching your issue with other taxpayers.
- If the issue is new and the IMT is still formulating its approach, getting cases with favorable facts in front of it may:
  - Influence pattern IDRs
  - Influence legal position
  - Increase impetus to give exam teams flexibility
Consider How Your Case Fits in With the IRS Strategy

- Consider the IRS docket on your issue.
  - Is the Service litigating? What are the facts in these cases?
    - Distinguish your facts
  - What is the strength of the cases further along than yours?
  - Coordinate with other taxpayers and consider which cases you want to go first

- For example, if you have a strong case and your issue hasn’t been tested:
  - Put pressure on the audit to move quickly to make your case one of the first
  - Show the IRS it doesn’t want your case to be the first: the issue owner executives don’t want to make law with cases that have good facts
Don’t Argue the Law

- IRS legal position is developed with consideration by multiple parties.
- One person doesn’t have authority to change position himself or herself.
- Agent will take a very pro-IRS view of the law and won’t listen to your alternative arguments.
- If you have an argument the IRS has never considered, arguing the law may have some value.
Case Elevation

- IRS has said its goal is to resolve cases at the lowest possible level.

- Normal progression under IRS Rules of Engagement:
  - Team manager
  - Territory manager
  - Director of field operations
    - DFO has direct line of communication with issue owner executive

- The issue owner executive is usually not involved in specific cases.
  - But an IRS official has said that a taxpayer may want to contact the issue owner executive if he/she has tried to elevate the case under normal channels without success.
Settlements

- Exam team must present proposed settlements of tiered, listed issues to the Technical Advisor, Issue Specialist, and/or Counsel before going forward with any resolution other than full concession by the taxpayer.
- Otherwise, whether the proposed settlement of a tiered, non-listed issue needs to be presented to the Issue Management Team may depend on, according to the Internal Revenue Manual:
  - Issue “maturity” (i.e., how well-developed the IRS position is, whether other cases have been settled, etc.)
  - Whether Counsel has provided published guidance
  - Whether the issue has been designated for litigation
  - Whether the issue is being considered for litigation in a different case
- Settlement of non-tiered issues may be more difficult when you also have a tiered issue.
  - May lose “horse-trading” opportunities
Fast Track Settlement of Tiered Issues

- Fast Track may be available to resolve tiered issues.
- Taxpayer, exam team, IMT coordinator, and Fast Track coordinator all must agree to use Fast Track.
  - It is generally helpful to get support from the exam team first because the manager can contact the other constituencies.
  - Taxpayer should be prepared to address the views and concerns of all constituencies.
    - For example, Appeals may look for settlements that can be used in other cases.
- Fast Track benefits:
  - Parties agree to seek a resolution within 120 days, which may conserve taxpayer resources.
  - Taxpayer may be able to achieve an agreement with the IRS decision-makers (IMT and Appeals will participate in Fast Track), which may provide a higher degree of certainty that the agreement will stand.
- Fast Track is a mediation process, so the taxpayer should be prepared to compromise.
Coordinated Industry Case Participants
What About Coordinated Industry Case Participants?

- Coordinated Industry Case (CIC) taxpayers have more formal examination procedures.
- At the initial meeting, the taxpayer will meet the CIC examination team.
  - In large cases, one revenue agent will be the case manager and will lead a team of agents. The case manager develops the audit plan and determines the scope of the audit.
  - One agent is the team coordinator. The taxpayer typically has most contact with this member of the audit team.
  - International, employee plan, financial products or other special examiners may be brought in for special roles.
  - Outside consultants may be brought in.
What About Coordinated Industry Case Participants?

- The taxpayer and the agents will discuss the audit plan.
  - The parties discuss office space and equipment to be provided to the agents, and the exam team’s approach to the audit.
  - Timing and a completion date may be discussed.
Market Segment Specialization Program (MSSP)

- Agents with expertise in the segment will develop MSSP audit guides, which describe industry issues and audit techniques.

- The audit guide is not binding on the agent examining the taxpayer.

- Under this program, the agents auditing the taxpayer may be specialists in the taxpayer’s segment.
Industry Specialization Program (ISP)

- The revenue agents will seek guidance regarding legal issues that are “coordinated” under the ISP program.

- Certain specialized industries have Industry and Issue Specialists.

- The Industry Specialists write position papers and advise examining agents regarding coordinated issues.

- Examining agents must raise coordinated issues, contact the Industry Specialist, and make adjustments in accordance with the ISP position papers.
TEFRA Partnership Provisions

- Partnership items reported on a taxpayer’s return may be separately examined at the partnership level. See I.R.C. §§ 6221-6234.

- Special rules govern notification to partners, partner participation in the audit, assessments against partners, and judicial review of the proposed adjustments.

- The tax matters partner (TMP) represents the partners as the contact person with the Service.
Are There Any Special Examination Programs?

- Limited Issue Focused Examination (LIFE)
- Fast Track Dispute Resolution
- Early Referral Request
- Accelerated Issue Resolution (AIR)
- Industry Issue Resolution (IIR)
- Comprehensive Case Resolution (CCR)
Limited Issue Focused Examination (LIFE)

- Large taxpayers have the option of entering into a streamlined audit process called the Limited Issue Focused Examination (LIFE) process. See Internal Revenue News Release IR-2002-13; IRM § 4.51.3.

- The purpose of the program is to focus the audit only on significant issues, making the audit process faster and less costly.

- Businesses with assets over $10 million are permitted to opt into the LIFE process, which will be detailed in a Memorandum of Understanding (MOU) executed by the taxpayer and the Service.
Limited Issue Focused Examination (LI FE)

- Under the agreement, the Service agrees to limit the scope of its examination to certain identified issues. Also, the Service agrees not to raise issues, and the taxpayer agrees not to assert affirmative claims, for issues under specified dollar thresholds.
- The agreement also provides for exchanges of information, a time schedule for the audit, and other agreed upon procedures.
- Some benefits of the LI FE process include:
  - Heightened materiality threshold results in a limited number of significant items being examined
  - Time span of the examination is reduced since fewer issues
  - Increased communication between Service and taxpayer means that issues are discussed earlier and resolved earlier
Fast Track Dispute Resolution

- The taxpayer and the revenue agents can seek to resolve certain audit issues under a Fast Track Dispute Resolution process. Notice 2001-67.


- The pilot program offered a Fast Track Mediation process or a Fast Track Settlement process.
Fast Track Mediation

- In Fast Track Mediation, an Appeals Officer acts as a mediator to help the parties resolve factual issues.

- Although Small Business/Self Employed (SB/SE) taxpayers continue to utilize the mediation program, it was unpopular with LMSB and was not made permanent.
Fast Track Settlement

- In Fast Track Settlement, the Appeals Officer helps the parties resolve factual or legal issues and exercises Appeals settlement authority to effect the settlement.

- The settlement program is viewed as successful and, as mentioned above, was made permanent. See Rev. Proc. 2003-40, which describes the eligibility criteria, the application process, and the settlement process.

- Issues must be fully developed, and the taxpayer must state its position in writing.

- Agreements are reflected in closing agreements. If no agreement is reached, the issues can be protested to Appeals.
Early Referral Request

- Taxpayers are permitted to ask Exam to refer developed, but unresolved issues to Appeals, while the revenue agents continue to audit other issues. Code § 7123(a); Rev. Proc. 99-28.
- Early referral can be a valuable tool to obtain the early resolution of “show stopper” issues.
- 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.
- ISP issues also may be referred to Appeals under the early referral program.
- 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.
Accelerated Issue Resolution (AIR)

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

- 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.

- While many issues may 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.

- The AIR agreement acts as a closing agreement for the issues addressed.
Industry Issue Resolution (IIR)

- The Industry Issue Resolution (IIR) program was first announced as a time-limited pilot program, but then was made permanent. Notice 2000-65; Notice 2002-20; Rev. Proc. 2003-36.

- The IIR program provides a process to obtain IRS guidance and resolve frequently disputed tax issues that are common in various industries.

- Taxpayers, or industry groups, may suggest issues in need of resolution to the Service, and can suggest possible options for resolving those issues. The goal is to obtain the resolution of issues that are the subject of repeated examinations affecting substantial numbers of taxpayers.

- Under the IIR program, the Service will issue guidance, likely in the form of a revenue ruling or procedure, that permits taxpayers to adopt the recommended treatment.
The Comprehensive Case Resolution (CCR) 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.

The program, which is jointly administered by LMSB, 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.

According to the Service and taxpayers, the CCR program has not been as successful as other IRS issue resolution programs.
Leaving Exam
How Will I Be Notified That The Agents Are Asserting A Proposed Adjustment?

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

- Section 6212 provides that the Service is prevented from making an assessment until after it has issued a statutory notice of deficiency (statutory notice, stat notice, or 90-day letter).
- The agents usually do not end the examination process by issuing a 90-day letter. Normally, the agents will issue a 30-day letter, which transmits a Revenue Agents’ Report (RAR) containing their proposed adjustments.
- 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.
- The letter transmitting the RAR is called the 30-day letter because it gives the taxpayer 30 days to submit a protest, which generally is necessary if the taxpayer wants the proposed adjustments to be considered by IRS Appeals.
How Does Issuance of A 30-Day Letter Affect Interest?

- The issuance of the 30-day letter triggers the running of “hot interest” on large corporate underpayments. Code § 6621(c)(2).
  - The taxpayer can make a payment to stop the running of interest.
  - The taxpayer can make a deposit in the nature of a cash bond to stop the running of interest.
When I Receive a 30-Day Letter, What Options Do I Have?

There are three options available to conclude the examination process after the issuance of a 30-day letter:

- Option #1 – Tentatively agree with the proposed deficiency.
- Option #2 – Fail to respond to the 30-day letter.
- Option #3 – File a Protest.
Option #1 - Tentatively Agree With The Proposed Deficiency

- The taxpayer may execute a Form 870, which waives the restriction that prevents the Service from making an immediate assessment.

- 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.

- The taxpayer does not waive the right to file a refund claim and to proceed to refund litigation.
Option #2 - Do Not Respond To The 30-Day Letter

- The Service is prohibited from making an assessment, but will issue a statutory notice of deficiency.

- The taxpayer has the right, within 90 days of the statutory notice, to file a petition in the Tax Court. No assessment will be made and the taxpayer need not pay the proposed deficiency.

- The taxpayer may pay the asserted deficiency and file a refund claim.
Option #3 - File A Protest

- 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).

- The taxpayer can request an extension of time to file the protest. The outer limit on extensions of time typically is 90 days.
Appeals
The Protest
Filing A Protest And Going to IRS Appeals

- The question: to protest or not to protest?
  - Why protest?
    - You obtain an additional opportunity to resolve issues. Appeals is able to settle issues on a hazards of litigation basis.
    - You keep your options to proceed to additional forums fully open.
    - You can delay payment of proposed tax increases.
    - You can learn more about the Service’s position, and refine your arguments.
Filing A Protest And Going to IRS Appeals

- Why not protest?
  - You may not want the delay, if you want to litigate as soon as possible.
  - You may not want to give the Service more time to develop its position.
  - You may not want to disclose your position in detail.
  - You may not want the Service to identify new issues.
    - By rule, Appeals is not supposed to raise new issues.
    - However, Appeals can return cases to Exam for consideration of new issues.
What Are The Procedures For Filing A Protest?

- The Service specifies the required form and contents of the protest. Publication 5.
  - Taxpayers may file either a full or a skeletal protest.
  - Taxpayers may raise affirmative issues in the protest.

- The taxpayer must sign a verification, under penalties of perjury, of the facts set forth in the protest.

- The taxpayer’s representative should attach a Form 2848, Power of Attorney.
Ex Parte Process
Can The Revenue Agent Respond To My Protest?

- The revenue agents may file a rebuttal.
  - The revenue agents receive the protest and may prepare a written rebuttal supporting their proposed adjustments.
  - The agents comment on legal and factual issues raised by the taxpayer in the protest.

- Formerly, Appeals Officers would meet with the revenue agents, without the taxpayer, prior to the Appeals conference, to discuss the protest and the rebuttal. Now, the Service prohibits these discussions unless the taxpayer is given the opportunity to attend.
Ex Parte Communications

- Appeals Officers are prohibited from having ex parte communications with other IRS employees to the extent those communications appear to compromise the independence of Appeals. Rev. Proc. 2000-43.

- Ex parte communications are communications between the Appeals Officer and any other IRS employee, without participation by the taxpayer, in which the merits of issues are discussed.

- If the Appeals Officer wants to discuss a case with the examining agent, the taxpayer must be offered the opportunity to participate.
Basic Appeals Procedures
Can Appeals Also Ask For An Extension Of The Assessment Period?

- Appeals also may ask for extensions of the period for assessment.

- Extensions can be effected using Form 872.

- Extensions also can be made using Form 872-A, which are open ended extensions. Open-ended extensions are terminated using Form 872-T.
What Are The Procedures For Conducting The Appeals Conference?

- Composition of the Appeals team:
  - Smaller cases may have a single Appeals Officer.
  - Larger cases will have an Appeals team, and the team will have a Team Chief, and Appeals Officers.

- Attendance at the conference:
  - Should taxpayer’s in-house representatives attend?
    - Yes – provide valuable information; help with negotiations
    - No – may cause Appeals to expect instant answers; makes the attending group much larger
  - Expert consultants may attend.
What Settlement Authority Do The Appeals Officers Have?

- Appeals is supposed to seek a “fair and impartial resolution” of the case.
- Appeals should apply a “hazards of litigation” standard in considering settlement of issues.
- Appeals should not raise new issues unless the ground for opening the issue is a substantial one and the potential effect upon the tax liability is material. Treas. Reg. § 601.106(d)(1); IRM § 8.6.1.4.
- Appeals consideration is not a continuation of the examination. New issues should not be raised, or threatened to be raised, for bargaining purposes.
- Appeals is permitted to ask for a legal opinion from counsel.
Special Appeals Procedures
Are There Special Procedures That I Can Use To Resolve Issues At The Appeals Level?

- Appeals Coordinated Issues (ACI)
- Technical Advice Requests
- Appeals Mediation Program
- Appeals Arbitration Program
Appeals Coordinated Issues (ACI)

- Certain issues have been designated ACIs, in order to obtain consistency in treatment.
  - Examples of such issues include:
    - Section 302/318 Basis Shifting Transactions
    - Section 351 Contingent Liability – Capital Loss Transactions
    - Section 461(f) Contested Liabilities Transactions
- Appeals officers have restricted ability to settle ACI issues.
- A current list of the ACIs can be found at:
Technical Advice Requests

- The taxpayer or the Appeals officer may file a request for technical advice with the IRS National Office. Rev. Proc. 2011-2.

- If the TAM or TEAM favors the taxpayer, Appeals will follow the TAM or TEAM.

- If the TAM or TEAM favors the Service, Appeals still is able to concede or settle the issue, although practically it will be more difficult to get Appeals to compromise.
The Appeals Mediation Program is authorized under section 7123(b)(1).

Mediation is optional and non-binding. A neutral third party mediator, without authority to impose his/her decision, assists the parties in settlement negotiations.

The Service 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 current procedures are set forth in Rev. Proc. 2009-44.

Factual issues, legal issues, ISP issues, and ACI issues are eligible for mediation.
The Appeals Arbitration Program is also authorized under section 7123(b)(1).

Arbitration is optional and binding. An arbitrator imposes a binding resolution on the parties. Arbitration is available only for factual issues after unsuccessful attempts to enter into a closing agreement under §7121.

The Service 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 Appeals Arbitration Program was formally established permanently in 2006 in Rev. Proc. 2006-44.
Leaving Appeals
What Options Do I Have Regarding How I Close The Case Out Of IRS Appeals?

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

- There are three major options for closing a case out of Appeals. The correct option to use depends on what subsequent course of action the taxpayer seeks to take.
  - Option #1 – Totally agreed case.
  - Option #2 – Partially agreed or unagreed case, with unagreed issues reserved for litigation in district court or the Court of Federal Claims.
  - Option #3 – Partially agreed or unagreed case, with unagreed issues left for litigation in the Tax Court.
Option #1 - Totally Agreed Case

- Compute the deficiency or overassessment due based on the resolution of the issues, and reflect that amount on Form 870-AD.

- The Form 870-AD is a waiver of the Service’s restrictions on assessment. The Service will assess the tax due and send the taxpayer a notice demanding payment.

- Under the doctrine of equitable estoppel, the Form 870-AD is intended to have binding effect on both parties.
Option #2 - Partially Agreed Case, With Unagreed Issues Reserved For Litigation In District Court Or The Court Of Federal Claims

- Compute the deficiency or overassessment due based on (i) resolving the settled issues as agreed, and (ii) treating issues to be reserved for litigation as resolved in favor of the Service.
- Execute Form 870-AD reflecting the resulting deficiency, reserving the right to file a refund claim with respect to reserved issues, and listing the issues reserved for litigation. IRM § 8.8.1.2.2 (“Settlement with Reservations”).
- The Form 870-AD is a waiver of the Service’s restrictions on assessment. The Service will assess the tax due and send the taxpayer a notice demanding payment.
- The taxpayer must pay the tax and file a timely claim for refund based on the issues reserved for litigation.
- If the taxpayer fails to reserve an issue, the issue cannot be raised in the claim for refund.
- If the government fails to reserve an issue, that issue cannot be raised, except as an offset in refund litigation.
Option #3 – Partially Agreed Case, With Unagreed Issues Left For Litigation In The Tax Court

- Compute the deficiency or overassessment due based on resolving the settled issues as agreed.
- Execute Form 870-AD reflecting the agreed deficiency, listing the issues that have been settled. IRM § 8.8.1.2.1 (“Partial Settlement”).
- The Form 870-AD is a waiver of the Service’s restrictions on assessment. The Service will assess the tax due and send the taxpayer a notice demanding payment.
- The Service will issue a statutory notice of deficiency seeking the tax due with respect to the unagreed issues.
- All issues listed as settled in the Form 870-AD are resolved.
  - All other issues (raised or not raised, known or not known) remain fully in dispute
  - The Service is permitted to raise any unsettled issue in the Tax Court as a “new matter.” Tax Court Rule 142.
- Having received a statutory notice of deficiency, the taxpayer may 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.
Post Appeals
Preparing for Refund Suit
Preparation For Refund Litigation

- If the taxpayer decides to take issues into refund litigation, the required first step is to pay the amount due.

- The second step is to file a Claim for Refund. I.R.C. § 7422. The refund claim is filed using Form 1120X.

- Each issue must be adequately described in the refund claim.

- Enough information must be provided to describe the issue to the Service adequately.
Preparation For Refund Litigation

- The refund claim must be filed within the statutory limitations period. I.R.C. § 6511.
  - If no Form 872 agreement extending the period of assessment has been executed, the claim must be filed within three years of the filing of the return (as extended).
  - If a Form 872 agreement extending the period of assessment has been executed, the claim must be filed within 6 months following the expiration of the extended assessment period. See Form 872.
  - Alternatively, a claim for refund can be filed within 2 years of the date a payment is made, but limited to the amount of that payment.
What Issues Can And Should I Raise In The Refund Claim?

- In order for an issue to be raised in the refund claim following a partial settlement, the taxpayer should have reserved the issue for litigation in the Form 870-AD.

- 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).
  - Therefore, it is critical to raise in the refund claim all of the issues that you want to litigate.

- Taxpayers that fail to file a timely, formal, and written refund claim containing an issue that they want to litigate may be able to contend that they have made an Informal Claim for Refund. See, e.g., Arch Eng'g Co., Inc. v. United States, 783 F.2d 190, 192 (Fed. Cir. 1986) (the minimum requirements for an "informal" refund claim include a written request for sums paid for a particular tax year).
What Action Will The Service Take Regarding The Refund Claim?

- The taxpayer can file the refund claim accompanied by a request that the Service immediately disallow the refund claim. IRS News Release IR-1600 (Apr. 26, 1976). Also, the taxpayer may contact its examining agents and ask for immediate disallowance.

- The Service may send the taxpayer a notice of proposed disallowance of the refund claim. The taxpayer can protest the proposed disallowance to IRS Appeals if Appeals did not previously consider the issue.
  - The Service 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.

- The Service may send a formal notice of claim disallowance. The notice must be sent by certified or registered mail. Code § 6532.

- The Service may not act at all on the refund claim.
Once The Refund Claim Is Disallowed, How Long Do I Have To File The Refund Suit?

- To avoid problems with the statute of limitations, the refund suit must be filed within two years of the date of the formal notice of claim disallowance.

- If the taxpayer executed Form 2297, suit must be filed within two years of the date on which the Service accepts that form.

- The statute of limitations for filing suit can be extended using Form 907, if the Service agrees to execute that form.

- If the Service does not respond within 6 months, the taxpayer is free to file suit.
If The Service Fails To Disallow The Refund Claim Can I File A Refund Suit Anyway?

- The taxpayer generally cannot file suit until after the Service denies the claim for refund.

- However, if the Service has not acted on the claim within 6 months of its filing, the taxpayer is free to file suit.

- If the taxpayer executed Form 2297, the taxpayer must wait 6 months to file suit.
Preparing for Tax Court Suit
Preparation For Tax Court Litigation

- A petition must be filed with the Tax Court.

- 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”).

- The petition must be filed within 90 days of the date of the statutory notice. Code § 6213.

- T. C. Rule 34 describes the required form and contents of the petition.
Choice of Forum
Choice Of Forum Issues

- Should I litigate in the Tax Court?
- Should I bring my refund suit in District Court?
- Should I bring my refund suit in Court of Federal Claims?
Important Issues to Consider - Tax Court

- What is the applicable precedent in the Tax Court?

- 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.

- Consider the background, experience and expertise of the Tax Court judges. Consider the “attitude” and approach that the judges have taken regarding similar 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.”
Important Issues to Consider - Tax Court

- 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”?

- Your opposing counsel will be an IRS attorney from IRS District Counsel’s office.

- The Tax Court’s rules of procedure will apply.
  - The Tax Court has limited discovery procedures available for the parties.
  - In the Tax Court, the parties must stipulate to facts to the extent possible.
  - Nationwide service of process to require witnesses’ appearance at trial.
Important Issues to Consider - Tax Court

- The Service is permitted to raise new issues as “new matters.” T.C. Rule 142. The Service 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.

- For example, suppose the taxpayer raises one issue in its petition, and that issue involves $100 of tax. If the Service spots a new issue, involving $1000 of tax, it can raise that issue in its answer. If the taxpayer loses both issues, its tax liability is increased by $1100. (Contrast this result with the different result reached in the refund context.)

- On these “new matters,” the Service has the burden of proof. However, typically this provides only a minimal advantage to the taxpayer.
Important Issues to Consider - 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.

- What is the applicable precedent in the district?

- 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.

- 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.
Important Issues to Consider - District Court

- 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.

- Jury trials are permitted in district courts.
  - Consider whether your case is one that you believe is suited to be heard by a jury.

- Opposing counsel will be from one of the regional litigation sections of the Tax Division of the Justice Department.
Important Issues to Consider - District Court

- Federal Rules of Civil Procedure will apply.

- Rules allow far more discovery than is permitted in the Tax Court.

- A trial subpoena can be issued only to witnesses within the district, or outside the district but within a 100 mile radius of the courtroom.

  - Thus, distant witnesses cannot be compelled to testify at the trial.
Important Issues to Consider - Court of Federal Claims

- The taxpayer may file suit in the Court of Federal Claims. This is a court with national jurisdiction, available to all taxpayers, wherever located.

- What is the applicable precedent in the Court of Federal Claims?

- 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.

- Typically, Court of Federal Claims judges will not be tax specialists, but also will not be generalist judges. The judges hear tax cases, patent cases, and claims against the United States. Consider the background, experience and expertise of these judges, and consider the “attitude” and approach that they have taken regarding various types of issues.
Important Issues to Consider - Court of Federal Claims

- No jury trials are permitted.

- Opposing counsel will be from the Court of Federal Claims section of the Tax Division of the Justice Department.

- The Rules of the Court of Federal Claims apply. These rules differ from, but are similar to, the Federal Rules of Civil Procedure.

- On a showing of good cause, the court can issue a trial subpoena to a witness that is outside the 100-mile radius of the place of trial.
How Do “New Issues” Affect Refund Litigation?

- In refund litigation, the government is permitted to raise new issues only as “offsets.” The government has no restrictions on its ability to raise new issues in its answer to the taxpayer’s complaint.

- However, there is a significant restriction on its ability to recover the tax associated with those new issues.

- The government cannot affirmatively collect the tax related to the “offset” issue, but can only use “offset” issues to reduce the amount of a recovery that the taxpayer otherwise would be entitled to.
How Do “New Issues” Affect Refund Litigation?

- For example, suppose the taxpayer raises one issue in its complaint, and that issue involves $100 of tax. If the government spots a new issue, involving (say) $1000 of tax, it is permitted to 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.)