

IRS Programs Offer Variety of Options for Settlement

Part 3 — Appeals and Other Advanced Settlement Opportunities

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In this discussion, we provide general information regarding the settlement of federal income tax controversies with the Internal Revenue Service.

The materials apply primarily to taxpayers under the jurisdiction of the Large and Mid-Size Business Division of the IRS, but may also be applicable to Small Business/Self Employed taxpayers in some situations. For ease of reference, we attempt to address the points of settlement in chronological order, that is, in the order that the settlement opportunity would arise from the earliest point of a planned transaction, through tax return reporting, examination, and appeals.

This is the final article in a three-part series about settlement procedures available to taxpayers in the IRS's Large and Mid-Size Business division, and to a lesser extent to Small Business and Self-Employed taxpayers. The first article, on prefiling settlements, appeared in 10 *IRS Practice Adviser Report*, 4/13/07, and the second, which discussed settlement opportunities during examination, was in 10 *IRS Practice Adviser Report*, 5/11/07).

Appeals Consideration of Issues—`New Issue Authority.'

If an issue is unagreed at the Examination level, and no Form 870 or 906 is signed with respect to the issue, and if the taxpayer desires further administrative consideration of it, the matter may be protested to Appeals for further settlement consideration.

It is the general policy of the IRS that an issue on which the taxpayer and Compliance have reached agreement in Examination, or has not been examined by Examination, should not be "reopened" by Appeals,¹ and that a "new issue" should not be raised by Appeals to the taxpayer's detriment unless the ground for such action is "substantial" and the potential effect on the tax liability is "material."²

Recently, the IRS has elevated its "new issue policy" to a formal policy statement. In Policy Statement P-8-2, dated Jan. 5, the IRS explained that an issue on which the taxpayer and Appeals agree should not be reopened by Appeals, nor should a new issue be raised, unless the ground for such action is substantial and the potential effect on the tax liability is material. Tax adjustments flowing from listed transactions are deemed to constitute a substantial ground with a material effect on tax liability.³

¹ IRM 8.6.1.4(1).

² IRM 8.6.1.4(1).

³ Policy Statement P-8-2(1).

Under IRS policy, the reopening of an agreed issue is treated as the raising of a new issue.⁴ While Appeals generally does not raise new issues, the taxpayer generally is free to do so.

In an administrative case, a new issue is any possible adjustment to or change in the taxpayer's return, or the Compliance report, raised by Appeals and not in dispute when the case was received by Appeals.⁵

A new issue in a docketed case is any possible adjustment to or change in an item affecting the taxpayer's tax liability that was not included in the notice of deficiency and is raised by the Appeals officer after the Tax Court petition is filed.⁶

The grounds for raising a new issue must be "substantial." "Substantial grounds" are those grounds which cause an Appeals officer to be quite certain (a high degree of certainty), at the time a new issue is raised, that the government would prevail if the issue were litigated.⁷ The government has the burden of proof when it raises a new (affirmative) issue in a docketed case. Therefore, except in unusual circumstances, Appeals will not raise the new issue in a docketed case unless provable facts to sustain the issue are readily available.

Although the burden of proof is not immediately upon the government when a new issue is raised in a nondocketed case, the standards for asserting a new issue are no less restrictive than the standards for raising a new issue in a docketed case.⁸ As noted above, a new issue will not be raised by Appeals unless the potential effect upon the tax liability is "material." In determining whether the potential effect is material, the IRS looks at the amount of tax that would result if an adjustment were made for the new issue.⁹

Form 870-AD and Reopening.

Two principal agreement forms are used in settling cases¹⁰:

- Form 870, Waiver of Restriction on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment; and
- Form 870-AD, Offer to Waive Restrictions on Assessment and Collection of Tax Deficiency and to Accept Overassessment (used almost exclusively by Appeals).

The Form 870-AD differs from the Form 870 in that Form 870-AD contains statements by

⁴ IRM 8.6.1.4.1(2).

⁵ IRM 8.6.1.4.1(4).

⁶ IRM 8.6.1.4.1(4).

⁷ IRM 8.6.1.4.2(5).

⁸ IRM 8.6.1.4.2(6).

⁹ IRM 8.6.1.4.2(7).

¹⁰ IRM 8.8.1.1.

both the taxpayer and the IRS against reopening the case whereas the Form 870 does not; the Form 870 agreement becomes effective as a waiver of restrictions on assessment when received, whereas the Form 870-AD becomes effective only upon acceptance by the IRS; and the suspension of interest under I.R.C. Section 6601(c) is controlled by the date the Form 870-AD becomes effective as a waiver, whereas the date of receipt by IRS controls for a Form 870.¹¹

Specifically, the Form 870-AD states that "[n]o claim for refund or credit will be filed or prosecuted by the taxpayer for the years stated on this form, other than for amounts attributed to carrybacks provided by law." And the Form 870-AD states that the case will not be reopened by the IRS unless, inter alia, there was "fraud, malfeasance, concealment or misrepresentation of a material fact," "an important mistake in mathematical calculation," or "excessive tentative allowance of a carryback."

Despite the specific language in the Form 870-AD precluding taxpayers from filing a claim for refund, taxpayers have filed claims, as well as subsequent refund suits when the IRS denied the claims. The outcomes have been varied. Most courts have determined that a closing agreement under Section 7121 is the exclusive means whereby tax disputes are settled with finality.

Thus, these courts have permitted taxpayers to pursue claims for refund after having signed Form 870-AD unless the IRS could demonstrate that the taxpayers made false representations.¹² However, a number of courts have barred such claims under the doctrine of equitable estoppel, though not on the basis that the agreement itself was legally binding.¹³

The IRS Jan. 5 issued a new policy statement explaining when mutual concession cases (using Form 870-AD) may be reopened. In IRS Policy Statement P-8-3, the Service separated the issue of reopening into those involving mutual concession and those resolved by "non-mutual concessions."

Under P-8-3, in mutual concession closed cases that are closed by Appeals, such cases will not be reopened by IRS action unless the disposition of the case involved fraud, malfeasance, concealment, or misrepresentation of material fact (i.e., language similar to where closing agreements can be avoided), an important mistake in mathematical calculation, or discovery that a return contains unreported income, unadjusted deductions, credits, gains, losses, etc. resulting from the taxpayer's participation in a listed transaction.

Therefore, it appears that Appeals has narrowed further the situations in which it will not consider the agreement binding on it, now limited to mathematical errors and limited shelter items. When a taxpayer requests a reopening of a mutual concession case, such reopening will be granted only in certain unusual circumstances favorable to the taxpayer, such as retroactive legislation.

Reopenings require the approval of either the Appeals director of field operations or the

¹¹ IRM 8.8.1.1.3.

¹² *Whitney v. United States*, 826 F.2d 896 (9th Cir. 1987); *Uinta Livestock Corp. v. United States*, 355 F.2d 761 (10th Cir. 1966); *Bennett v. United States*, 231 F.2d 465 (7th Cir. 1956).

¹³ See, e.g., *Flynn v. United States*, 786 F.2d 586 (3rd Cir. 1986); *Elbo Coals Inc. v. United States*, 763 F.2d 818 (6th Cir. 1985); *Stair v. United States*, 516 F.2d 560 (2d Cir. 1975); *Cain v. United States*, 255 F.2d 193 (8th Cir. 1958).

Appeals director of technical services.¹⁴

In non-mutual concession closed cases under P-8-3, the IRS will not reopen the case unless the prior disposition involved "fraud, malfeasance, concealment or misrepresentation of material fact, an important mistake in mathematical calculation, or such other circumstances that indicates that failure to take such action would be a serious administrative omission." The policy statement concludes by stating that a non-mutual concession case may be reopened by a taxpayer by an appropriate means, such as by the filing of a timely claim for refund.¹⁵

Delegation Orders 236 and 4-25.

Delegation Order 236¹⁶ provides LMSB and SBSE Examination personnel the delegated authority to settle certain technical adviser program issues and appeals technical guidance program coordinated issues with taxpayers under examination.

These issues, which may arise in a year under examination, may be settled by Examination by compromise using litigation hazards, but only if the same or similar issue has previously been consistently settled by Appeals for the same or prior tax period and:

- the facts are substantially the same as in the Appeals settled tax period;
- the legal authorities are unchanged;
- the Appeals settlement was done on the merits of the particular issue independent of other issues (i.e., the issue was not "traded off" for the settlement of other issues in the Appeals settlement); and
- the issue was settled in Appeals with the same taxpayer (including consolidated or unconsolidated subsidiaries) or another taxpayer who was directly involved in the transaction or taxable event in the settled period.

Nothing in D.O. 236 provides the method of settling such matters, and Examination uses its normal settlement forms—that is, either a Form 870 or closing agreement—to effect the settlement. The finality of these agreements (and the closure of the examination) has been discussed earlier.

Delegation Order 4-25, dated June 7, 2005,¹⁷ provides similar authority to settle particular issues by compromise in Examination if those issues are the subject of written settlement positions in technical adviser (TA) program issues and the Appeals technical guidance program (Compliance coordinated and Appeals coordinated). The examination manager must get the review and concurrence of both the Appeals technical guidance coordinator

¹⁴ Policy Statement P-8-3(1) and (2).

¹⁵ Policy Statement P-8-3(3) and (4).

¹⁶ Rev. 3, Aug. 25, 1997.

¹⁷ Formerly Delegation Order 247.

and Compliance technical adviser for the specified industry or issue before finalizing a settlement with a taxpayer.

Again, the process does not dictate the method of settling such matters, and Examination uses its normal settlement forms (i.e., either a Form 870 or closing agreement) to effect the settlement. The finality of these agreements (and the closure of the examination) has been discussed earlier.

Accelerated Issue Resolution.

The accelerated issue resolution (AIR) program is a process designed to advance the resolution of issues arising from an audit of a CIC taxpayer from one or more tax periods to other future tax periods for which returns have been filed.¹⁸ An AIR agreement may be entered into with respect to any issue under the jurisdiction of the LMSB director of field operations arising from an audit of a CIC taxpayer for taxable periods ending prior to the date of the agreement and related specific items affecting other taxable periods.¹⁹

Upon the request of the taxpayer to enter into an AIR agreement, the director of field operations may grant the request where:

- there appears to be an advantage in having the issues permanently and conclusively closed for the years covered by the AIR agreement or the taxpayer shows good and sufficient reasons for a closing agreement,
- it is determined that the United States will sustain no disadvantage through the consummation of such an agreement, and
- the law is applied to the facts without taking into account hazards of litigation or the provisions of Delegation Order No. 236 are applicable and are satisfied.

An AIR agreement is a closing agreement under Section 7121 between the Service and the taxpayer relating to one or more specific issues that arise from an audit for taxable periods ending prior to the date of agreement. As a result, the AIR agreement is final and binds the parties to the resolution for those specific issues and taxable periods identified therein. The AIR agreement does not have an effect on any other taxable periods or issues not covered under the agreement.

Technical Advice Memorandums.

During the course of Examination or Appeals consideration, a technical issue may arise on which the IRS technical position is not clear. In that event, Examination or Appeals and the taxpayer may request technical advice.

Technical advice is advice or guidance in the form of a memorandum furnished by an IRS associate chief counsel's office. The question must relate to the interpretation and proper application of tax law, tax treaties, regulations, revenue rulings, notices, or other precedents published by the National Office to a specific set of facts that concerns the treatment of an item in a year under examination or appeal.²⁰

Technical advice is given only upon request by the government, concerning only closed

¹⁸ Rev. Proc. 94-67 , 1994-2 C.B. 800.

¹⁹ Delegation Order No. 97 (Rev. 31), Paragraph 4, 1992-2 C.B. 357.

²⁰ Rev. Proc. 2007-2 , Section 3.01, 2007-1 IRB 88.

transactions. However, taxpayers are afforded the opportunity to participate in the technical advice process and may ask the government to request technical advice on a particular issue.²¹

Technical expedited advice memorandums are a vehicle to provide advice or guidance in an expedited manner for matters that are appropriate for technical advice memorandums but for which the IRS desires to streamline the process.

With respect to a specific set of facts, a T.A.M. or a T.E.A.M. is appropriate when the law and regulations are not clear on the issue under consideration and there is no published precedent for determining the proper treatment of the issue, the issue is unusual or complex enough to warrant consideration by the National Office, or IRS field personnel believe that securing technical advice from National Office would be in the best interest of the Service.²²

Once a T.A.M. or T.E.A.M. is issued, Examination must process the taxpayer's case on the basis of the conclusions set forth in the T.A.M. or T.E.A.M. Said another way, Examination is bound by the T.A.M. regardless of whether it is favorable to the taxpayer or favorable to the Service.²³

If the matter is processed to Appeals, Appeals is bound by technical advice that is favorable to the taxpayer. However, if the technical advice is unfavorable to the taxpayer, the taxpayer is not bound by it, and if the matter is processed to Appeals, the Appeals office may settle the issue in the usual manner under existing authority, giving the T.A.M. whatever weight it concludes it deserves in the circumstances.²⁴

Generally, a holding in a T.A.M. or a T.E.A.M. is applied retroactively to the issue under examination. However, in rare and unusual circumstances the associate chief counsel with jurisdiction over the technical advice memorandum or technical expedited advice memorandum may exercise the discretionary authority under Section 7805(b) to limit the retroactive effect of the holding.²⁵

If a T.A.M. or T.E.A.M. relates to a continuing action or a series of actions, it is ordinarily applied and can be relied upon by the taxpayer until it is specifically withdrawn or until the conclusion is modified or revoked by enactment of legislation, ratification of a tax treaty, or issuance of a U.S. Supreme Court decision, regulations (temporary or final), a revenue ruling, or other statement published in the Internal Revenue Bulletin.²⁶

Generally, a T.A.M. revoking or modifying a letter ruling or an earlier T.A.M. will not be

²¹ Id. at Section 3.03.

²² IRM Section 4.2.3.4.2.2.

²³ Id. at Section 12.

²⁴ Treas. Regs. Section 601.106(f)(9)(viii)(c).

²⁵ Rev. Proc. 2007-2 , Section 13.01.

²⁶ Id. at Section 13.03.

applied retroactively if²⁷:

- the applicable law has not changed;
- the taxpayer directly involved in the letter ruling or earlier T.A.M. relied in good faith on it; and
- revoking or modifying the letter ruling or earlier TAM would be detrimental to the taxpayer.

The effect therefore of a T.A.M. or T.E.A.M. depends upon whether it is taxpayer favorable or unfavorable. If the T.A.M. or T.E.A.M. is taxpayer unfavorable:

- and the taxpayer accedes to the IRS position, either Form 870 or Form 906 is processed in the normal fashion;
- and the taxpayer does not accede to the IRS position, Examination must follow the T.A.M. and follow that advice contrary to the taxpayer's position; and
- whether or not the taxpayer accedes, Appeals may later settle the matter in the normal fashion.

If the ruling is taxpayer favorable, Examination is bound to follow it, and the issue is considered resolved unless (as explained above) the T.A.M. is revoked. Even then, the revocation is generally not applied retroactively.

Fast-Track Settlement.

Rev. Proc. 2003-40²⁸ formally established the fast-track settlement (FTS) program, which employs various alternative dispute resolution techniques to promote agreement between taxpayers and the IRS Examination function. An FTS Appeals official serves as a neutral party, but instead of performing in a traditional Appeals role he or she uses dispute resolution techniques to facilitate settlement between the parties.

FTS applies after the IRS issues the Form 5701 (Notice of Proposed Adjustment) and the taxpayer provides a written response, but before the date on which the Service issues the first letter of proposed deficiency that allows the taxpayer an opportunity for administrative review in the Office of Appeals (30-day letter).

During the session, the FTS Appeals official may propose settlement terms for any or all issues. If the parties resolve any of the disputed issues at the conclusion of the session, the parties and the FTS Appeals official sign the FTS session report acknowledging acceptance of the terms of settlement for purposes of preparing computations. If the parties fail to resolve any issue in FTS, the taxpayer retains the option of requesting that the issue be heard through the traditional Appeals process.

With respect to agreed issues, the signature of the parties on the FTS session report does not waive restrictions on assessment, terminate consents to extend periods of limitation, start the running of any periods of limitation, or constitute agreement to close the case.²⁹

²⁷ Id. at Section 13.02.

²⁸ 2003-1 C.B. 1044.

²⁹ Rev. Proc. 2003-40 , Section 5.07.

However, unless specific conditions warrant altering the agreement (for example, a subsequent authoritative decision that materially alters the basis for the agreement), the basis of settlement will not be modified after the FTS session report is signed.³⁰ Rather, the FTS Appeals official will draft the appropriate settlement document (Form 870 or closing agreement) to reflect the agreed-upon treatment of the issue.

A settlement achieved through the FTS program will have the same character and effect as one achieved through the traditional Examination or Appeals process.

Fast-Track Mediation.

Fast-track mediation (FTM) was established by Rev. Proc. 2003-41³¹ to expedite case resolution and to expand the range of dispute resolution options available to taxpayers. It is initiated only after an issue has been fully developed.

If the case is accepted into the FTM program, an Appeals manager will assign the case to the FTM Appeals official who has been trained in mediation. The FTM Appeals official will serve as a neutral party.

Unlike the fast-track settlement program, in the fast-track mediation program the FTM Appeals official does not have settlement authority and will not render a decision regarding any issue in dispute. The issues submitted to the FTM process may only be resolved if both the taxpayer and the IRS reach an agreement that could have been reached in Examination within typical Examination authority.³² If the parties do reach agreement, Examination will prepare the routine documents for resolution, without regard to the settlement method here used.

Because of the limitation in settlement authority inherent in the mediation program, very few cases are resolved under the mediation program and nearly all taxpayers and Examination elect to resolve the matter under the settlement alternative. Under either program, however, the effect of the settlement is the same as if the matter had been routinely settled by Examination or Appeals.

Competent Authority.

The U.S. competent authority assists taxpayers with respect to matters covered in the mutual agreement procedure provisions of tax treaties. Tax treaties permit taxpayers to request assistance in order to relieve economic double taxation arising from an allocation under I.R.C. Section 482 in one country that would have an adverse effect in a foreign country.³³

The process is usually invoked when one country recommends an adjustment on examination that would/could result in double taxation in another country.

For example, if an agent in the United States increased the sales price of an automobile sold by a foreign parent into the United States, then the foreign parent should be allowed to increase their cost of goods sold in the foreign country. Accordingly, the foreign parent would have to pay less income tax in the foreign country to make up for the increase in

³⁰ Id. at Section 6.01.

³¹ 2003-1 C.B. 1047.

³² Rev. Proc. 2003-41 , Section 5.07.

³³ Rev. Proc. 2006-54 , 2006-49 IRB 1035.

income they have to report in the United States. Because there is a possibility that the foreign company could wind up in a double tax situation if the foreign tax authority did not provide relief by refunding the tax for the increase in the cost of goods sold, the CA process could be invoked.

In this process, the designated U.S. competent authority will consult with the appropriate foreign competent authority and attempt to reach a mutual agreement that is acceptable to all parties.

If a taxpayer has executed a closing agreement with the IRS (whether or not contingent upon competent authority relief) with respect to a potential competent authority issue, or reaches a settlement on the issue with IRS Appeals pursuant to an executed closing agreement or other written agreement such as Form 870-AD, the U.S. competent authority will endeavor only to obtain a correlative adjustment from the treaty country and will not undertake any actions that would otherwise change such agreements.

After the negotiations are concluded, the U.S. competent authority will notify a taxpayer of any agreement that the U.S. and the foreign competent authorities reach. If the taxpayer accepts the resolution reached by the competent authorities, the agreement will provide that it is final and is not subject to further administrative or judicial review.

If the competent authorities fail to agree, or if the agreement reached is not acceptable to the taxpayer, the taxpayer may withdraw the request for competent authority assistance and may then pursue all rights otherwise available under the laws of the United States and the treaty country.³⁴

The taxpayer may be requested to enter into a closing agreement with the commissioner that reflects the terms of the mutual agreement and of the competent authority assistance provided. As such, the resolution to competent authority settlement reflects the same settlement characteristics as other closing agreements.

IRS Settlement Initiative Programs.

From time to time, the IRS has announced settlement initiatives offering to resolve particular transactions commonly known as tax shelters or listed transactions.³⁵ In general terms, the commissioner offered to settle with persons by disallowing claimed tax benefits associated with the transaction in a manner consistent with relevant published guidance providing the Service's view of the transaction.

For certain transactions, that would mean that the transaction will be treated as not having occurred for tax purposes and the taxpayer needed to concede all claimed tax benefits of the transaction for all taxable periods not barred by the period of limitations on assessment. For other transactions, the Service's position was that the transaction had to be recharacterized in a manner consistent with its substance, and the taxpayer needed to concede all claimed tax benefits inconsistent with that substance. Often, an agreed-upon penalty regime is also part of the offer.

To accept the offer, a taxpayer must agree to the terms of the offer and comply with the Announcement 2005-80 provisions. This would usually mean filing an application with the designated program officials within the period allotted, signing a closing agreement within a

³⁴ Rev. Proc. 2006-54 , Section 12.05.

³⁵ See e.g., IR-2004-87 ("Son of BOSS" (bond option sales strategy) transactions); Announcement 2005-80 (myriad other transactions).

fixed period and in the form provided by the IRS, and paying the tax liability.³⁶

Industry Directors Directives.

Industry directors directives were created to allow industry directors to provide direction to LMSB personnel at large.³⁷ Directives issued pursuant to this process are intended to provide direction for the effective utilization of examination resources in relationship to the identification, development, and resolution of issues. Such directives reflect IRS management decisions that are made to better balance resources and workload priorities.

Industry directors directives may address examination planning, issue development, audit techniques, operational guidance, and resource allocation.

Although these directives are reviewed by IRS Counsel,³⁸ they are explicitly not official pronouncements of law or the IRS interpretations of law, and cannot be used, cited, or relied upon as such. However, an industry directors directive is a pronouncement to field personnel on how to conduct their efforts in identifying, developing, and resourcing specific issues. It is expected that these directives be followed by field personnel as they conduct their examination activities.

Therefore, taxpayers can expect that local examination teams will follow these directives and that their issue will be developed and resolved in a manner consistent with the industry directors directive.

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³⁶ See Announcement 2005-80, Section 5.D.

³⁷ IRM 4.51.2.6.

³⁸ IRM 4.61.2.6.2.