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## Alternatives

TO THE HIGH COSTS OF LITIGATION

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## Building a User-Friendly Internal Revenue Service

### AN INTRODUCTION TO THE APPEALS OFFICE

BY DANIEL L. BLACK JR.

For the Office of the National Director of Appeals at the U.S. Treasury Department's Internal Revenue Service, 1999 was a year of change—and preparation for even more change.

Appeals is one of the oldest and largest dispute settlement organizations in the United States. It has about 2,100 employees, of which 1,100 are Appeals officers. It is part of the Office of the Commissioner of the Internal Revenue Service. Appeals has worked to implement the many changes required by the IRS Restructuring and Reform Act of 1998, referred to in this article as RRA 98. At the same time, officers and staff are planning a redesigned Appeals for early this year. This is happening in addition to the daily work of resolving tax disputes.

This article discusses some of the legislative changes Appeals is implementing. It also covers some of the program developments relating to large corporate cases in Appeals, and plans for a redesigned Appeals office.

Appeals' role has been cast in a new light under RRA 98. Section 1001 requires the IRS to ensure an independent Appeals function, and prohibits ex parte communications between appeals officers and other IRS employees to the extent that such communi-

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Daniel L. Black Jr. is National Director of Appeals for the Internal Revenue Service in Washington, D.C. The content of this article is the opinion of the writer and does not necessarily represent the position of the Internal Revenue Service.

### ADR PROGRAMS ARE SET FOR TAXPAYERS' USE

BY THOMAS CARTER LOUTHAN

From its beginnings in 1927, the Internal Revenue Service's National Office Appeals has continually strived to improve customer service by expanding existing programs and developing new ones.

Under the IRS Restructuring and Reform Act of 1998, P.L. 105-206, referred to in this article as RRA 98, the role of Appeals is cast in a new light. Section 1001 requires the IRS Commissioner to ensure an independent appeals function within the IRS, and prohibit ex parte communications between appeals officers and other IRS employees to the extent that such communications appear to compromise the independence of

the appeals officers. (Notice 99-50, 1999-40 I.R.B. 444, contains a draft revenue procedure with guidance in a question-and-answer format about the prohibition on ex parte communications.)

As the IRS shifts toward becoming a more customer-oriented agency, the Internal Revenue Service's commitment to the Appeals administrative dispute resolution process is reaffirmed by the following principles in the recently published Policy Statement P-8-1, Internal Revenue Manual, Part 1, Handbook 1218, Policies of the IRS:

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GOVERNMENT  
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## BUILDING A USER-FRIENDLY INTERNAL REVENUE SERVICE

# An Introduction to the Appeals Office

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tions appear to compromise the independence of the Appeals officers.

### REDESIGNING APPEALS

Commissioner Charles O. Rossotti's vision for the IRS's future is described in three essential goals:

- Service to each taxpayer.
- Service to all taxpayers.
- Productivity through a quality work environment.

Five principles will guide the IRS to significantly improve service to taxpayers:

- Understanding and solving problems from the taxpayer's point of view.
- Expecting managers to be accountable.
- Using balanced measures of performance.
- Fostering open, honest communications.
- Insisting on total integrity.

A major goal in the IRS's restructuring is to enhance its ability to focus on the needs of specific groups of taxpayers. Realigning the IRS into different segments will promote this.

Another goal is to flatten the organization and place leadership closer to taxpayers. This will improve overall responsiveness to taxpayers and reduce the time required to elevate various issues to the management level where decisions are made. The realignment will provide end-to-end accountability for taxpayers. Operating divisions will have the resources and the responsibility to meet taxpayer needs.

Appeals will be realigned in a similar manner to that of the entire IRS. The three divisions will be Wage and Investment; Small Business/Self Employed/Tax Exempt/Government Entity; and Large & Mid-Size Business.

In the new Appeals structure, there will be Appeals Large & Mid-Size Business geographic area managers. The area and second-line managers will now be in a position to deal with special needs and circumstances and will have greater responsibility for  
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## ADR Programs Are Set for Taxpayers' Use

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(1) Taxpayers are generally entitled to appeal many of the disputes arising under the Internal Revenue Code, regulations and procedures. They also are entitled to an explanation of the Appeals process, and to have a timely conference and resolution of their dispute.

(2) Local Appeals offices are separate from and independent of the IRS office that proposed the adjustment in question. Issues should be fully developed by compliance functions before an administrative appeal.

(3) The Appeals Office is the only level of appeal within the IRS, and generally is the principal administrative function that exercises settlement authority to resolve tax disputes for cases that are not docketed in the U.S. Tax Court. Revenue Procedure 87-24, known as the subsequent procedure, describes when cases docketed in the U.S. Tax Court are referred by district counsel to Appeals for consideration of settlement. The National Director of

Appeals, as the administrative dispute resolution specialist in tax matters for the IRS commissioner, has authority over the Appeals field operations throughout the country.

(4) The IRS supports the development and use of alternative dispute resolution techniques by Appeals to create an administrative forum, independent of compliance functions, to efficiently prevent or resolve disputes. Appeals is encouraged to survey its customers and expand ADR test programs to enhance taxpayer service. RRA 98's Section 3465 creates a new IRS Section 7123, which codifies Appeals' alternative dispute resolution procedures.

There are other ADR-oriented measures in place. The Administrative Dispute Resolution Act of 1996, Pub. L. No. 104-320, encourages federal agencies to use all ADR techniques in the federal administrative process to resolve disputes. Appeals also is committed to advancing its customer service program; it  
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### ACKNOWLEDGMENT

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# An Introduction to the Appeals Office

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doing so. There will be five Appeals Large & Mid-Size Business geographic area managers.

Many of the changes will be invisible to taxpayers. Cases still will be worked in the same places, with the same personnel. Appeals expects to begin operating under the new design in June 2000.

### HOW APPEALS WORKS

Appeals is led by the National Director and Deputy National Director in Washington, D.C. There currently is a Regional Director of Appeals in each of the four IRS regions. Resolving the country's federal tax controversies without litigation in a fair and an impartial manner has been the mission of the Internal Revenue Service's Appeals organization since 1927. For years, Appeals consistently has been successful in settling the vast majority of its cases, a rate of about 85% to 90% of the thousands of income tax cases in its inventory. Each year, Appeals resolves more than 68,000 cases.

Appeals officers are some of the most experienced IRS employees. They are experts at reviewing the unique facts and merits of each case and evaluating everything relevant to arrive at the right settlement for each case. Appeals is bound by the Internal Revenue Service Code, regulations, and IRS positions favorable to taxpayers. When an IRS position is unfavorable to the taxpayer, Appeals still can settle the case.

Most income tax cases come to Appeals when adjustments or penalties are proposed, a claim for a refund, credit or abatement is disallowed, or the IRS takes enforcement action. The taxpayer can respond to proposed adjustments or assessments in one of four ways:

- The taxpayer may agree with the adjustment and pay the deficiency, closing the case; or
- The taxpayer may disagree and provide documentation or other support of its position sufficient to resolve the case; or
- The taxpayer may file a protest and have Appeals consider the dispute; or
- The IRS issues a Notice of Deficiency. A taxpayer may take the case to the U.S. Tax Court before paying the amount shown in the notice. It is important to recognize that even if the taxpayer chooses to file a U.S. Tax Court petition, the case will be forwarded to Appeals by the Chief Counsel for settlement consideration before trial.

*Independence:* Appeals has been delegated the authority to settle tax controversies by the Commissioner. Appeals is separate from the Compliance functions, which propose changes to tax and take other enforcement actions, and from the Chief Counsel, whose role is litigating tax disputes. The independent authority of Appeals ensures a fair and impartial review of all cases. The National Director of Appeals' line authority over

Appeals operations promotes uniformity and consistency in settlements nationwide.

*Settlement Authority:* Within the Appeals organization, settlement authority is delegated to Appeals Chiefs, Associate Chiefs, and Team Chiefs in Appeals offices throughout the country. The Appeals officers hold conferences, discuss issues and consider proposals to settle disputes. Their recommendations are subject to approval by the Appeals Chief, Associate Chief, or Team Chief on behalf of the IRS. Settlements may be related to the uncertainty of a factual dispute, or uncertainty as to the interpretation or application of the law to the facts of a case. Appeals has authority to estimate "hazards of litigation" in negotiating a reasonable settlement.

*Taxpayer Conferences:* Appeals has built a strong record of success through our conferences with taxpayers, and giving disputes a fresh look. The vast majority of cases are settled using this process.

Still, Appeals is exploring new ways of doing business and new ways to improve its programs and services. Some of them are described below.

### APPEALS PERFORMANCE MEASUREMENTS

With the IRS moving to a "balanced measurement" system, Appeals examined how it measures its performance. Overall, the balanced measures consist of three equally weighted components:

- Customer satisfaction.
- Employee satisfaction.
- Business results (quality and quantity).

The final measures for Appeals have been tentatively approved, and are similar to those of other IRS functions--including the Coordinated Examination Program, which is now referred to as Large & Mid-Size Business. Both customer and employee satisfaction will be measured using surveys currently in place. Each survey provides statistically valid data about the feelings of employees or customers, and each will have a significant impact on how Appeals conducts business in a balanced-measures environment.

### COLLECTION, SERVICE CENTER & APPRAISAL SERVICES

The Office of the National Director of Appeals provides policy oversight, national measurements, and field assistance in the following programs.

*Collection Appeals:* The Collection Appeals Program, or CAP, was started in April 1996. It allows taxpayers to administratively appeal lien, levy and seizure actions proposed by or made by the IRS. This is the first time in the history of U.S. taxation

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## An Introduction to the Appeals Office

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that an appeal on these collection actions is available through an independent organization such as Appeals. For CAP issues, any taxpayer may request an appeal. The Appeals office's goal is to reach a decision in five days. This ensures taxpayers a quick decision and that collection activities will not be unnecessarily delayed. Appeals of installment agreements are included in the program.

RRA 98 made numerous changes to collection procedures that affect Appeals, with the biggest impact expected to be due process Appeals hearings for lien and levy actions. The act also added appeal rights for rejected installment agreements and codified appeal rights for "Offers in Compromise."

*Service Center:* Appeals receives referrals from several service center functions. The issues involved in these cases are increases to income; simple examination issues such as deductions, credits, and expenses; claims for a refund, credit or abatement; penalty assessment, or the requirement to file a tax return. Taxpayers' disputes with service center adjustments, assessments, or enforcement actions are handled through an Appeals conference, either by telephone or in person.

Proposed initiatives to simplify the process of disputing service center changes to a taxpayer's tax return are being tested. This includes rewriting service center examination, collection, and underreporter letters to taxpayers in plain English, and having Appeals representatives at the service center.

*Employment Tax Changes:* The IRS announced in Notice 98-21 that it is extending its Classification Settlement Program indefinitely. The program applies to federal employment tax liability resulting from worker misclassification.

*Administrative Costs:* I.R.C. Section 7430 provides that a taxpayer who substantially prevails in an administrative or court proceeding may be awarded a judgment for reasonable costs incurred in such proceedings. A party moving for administrative costs must show that: (1) the moving party did not unreasonably protract the administrative or judicial proceeding, and (2) the moving party was the prevailing party.

*Interest Abatement:* Section 6404(e)(1) provides that the Commissioner may abate the assessment of all or any part of interest on any deficiency attributed in whole or part to any unreasonable error or delay by an IRS officer or employee (acting in an official capacity) in performing a ministerial or managerial act; or payment of any tax to the extent that any error or delay in payment is attributable to an IRS officer or employee being unreasonably erroneous or dilatory in performing a ministerial or managerial act. Congress intended abatement of interest to be used in instances where failure to abate interest would be widely perceived as grossly unfair.

### WHAT'S IT WORTH?

Appeals also provides specific valuation expertise to Appeals offices and other IRS functions in the areas of Business Valuation, Reasonable Compensation, Real Estate, and Art Valuation, all of which are explained below. Appeals has been successful at identifying the strengths and weakness of taxpayers' valuations. As a result, many valuation issues are resolved without trial.

*Business Valuation:* Appeals financial analysts provide assistance on some of the most complex valuation issues facing the IRS. Recent issues include intangible assets, covenants not to compete, capital gain discounts, marketability discounts and minority interest discounts. At the Appeals level, this office provides assistance at conference and will critique the taxpayer's appraiser's report, the IRS engineer's report and the revenue agent's position and point out the strength and weakness of their positions.

*Reasonable Compensation:* Appeals provides financial analysis on reasonable compensation issues to determine whether, from an independent financial investor's viewpoint, a corporation would continue to pay the salary now being paid to an officer-stockholder. This test includes reference to several well-known salary studies and an analysis of companies' financial data.

*Real Estate:* The Office of the National Director of Appeals provides critiques of both IRS and taxpayers' appraisals, generally involving complex special use properties and property rights. Special use appraisals have included a casino hotel, a carbon black plant, a ski resort, and regional shopping centers, in addition to more common commercial and industrial properties. The Appeals appraiser also advises and provides real estate valuation related information to Appeals officers. Work has also involved complex intangible issues such as balloon and take-back mortgages involving cash equivalency calculation; large leases; and fractional ownership interests.

*Commissioner's Art Advisory Panel:* The panel assists the IRS by reviewing and evaluating property appraisals submitted by taxpayers in support of the fair-market value claimed on works of art involved in federal income, estate and gift tax cases in accordance with the Internal Revenue Code. All taxpayer cases selected for an audit with a claimed value of \$20,000 or more must be referred to National Office Art Appraisal Services for review by the Commissioner's Art Advisory Panel. The panel members, 25 renowned art experts who serve without compensation, have recommended adjustments of more than \$573 million on taxpayers' claims in the past 19 years. Panelists are not told whether an item is being valued for a contribution deduction or for an estate or gift tax valuation. Valuing art work is important for such tax purposes as estate and gift taxes and the charitable contribution deduction. Rev. Proc. 96-15, 1996-1 C.B.

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627, tells taxpayers how to obtain an IRS review of their artwork valuations before filing returns.

### ALTERNATIVE DISPUTE RESOLUTION

Of course, alternative dispute resolution is the basis of what Appeals does. In response to growing taxpayer interest, Appeals has established a number of ADR procedures intended to resolve tax disputes more effectively and efficiently. These procedures primarily are designed to identify particular issues in a case which, if resolved, could serve to bring the entire case to an expeditious conclusion. For example, Appeals recently has published procedures on mediation and on early referral. See the accompanying article for a rundown of formal Appeals ADR customer service efforts, and descriptions of recent improvements and test programs.

### EXAMINATION-RELATED APPEALS

The Office of Corporate and Individual Income Taxes oversees virtually all appeals programs that emanate from the Examination Division, including field examinations, office examinations, the Coordinated Examination Program, or CEP, and work from the excise and estate tax areas. In addition, the office is responsible for developing guidelines and implementing procedures relating to a number of RRA 98 provisions.

The following are brief descriptions of some of our major activities:

*The Appeals Large Case Program:* All CEP cases, regardless of the amount in dispute, are included in the Appeals large case program. Although the large cases constitute only about 1% of the total Appeals workload, they account for more than 90% of the dollars in dispute.

The large case program is under the direction of a manager in each region, known as the Assistant Regional Director of Appeals, Large Case. Appeals uses a team approach for handling most of its large cases. The team approach enables Appeals to consider many issues simultaneously and to resolve cases more quickly and efficiently.

*Large Case Quality & Process Review:* Appeals-conducted Large Case Quality and Process Reviews combine traditional review of the quality of decisions with process analysis. The reviews concentrate on process, analyzing data from every point in the life cycle of the case during Appeals consideration. The analysis traced the cases from Appeals' receipt through all significant intermediate steps leading to ultimate closure.

*Industry Specialization Program:* The Industry Specialization Program is designed to provide a coordinated examination and litigation effort for designated issues in specific industries. The program is intended to promote uniform and consistent treatment of key issues nationwide. The Examination Division and Chief Counsel determine which industries are in the program and the specific issues that are coordinated.

### *Examination Settlement Authority (Delegation Orders 236 & 247):*

To promote the resolution of cases at the lowest possible level, the IRS expanded Examination Division case managers' authority to settle certain issues within their jurisdiction in CEP cases.

Under certain defined circumstances, Delegation Order 236 (Rev. 3) allows case managers to settle a CEP case issue, regardless of the amount, on the same basis settled in Appeals in a previous, subsequent or the same tax period.

Delegation Order 247 (Rev. 1) gives settlement authority to case managers for certain issues in CEP cases, regardless of the amount of tax at issue, that are coordinated in the Industry Specialization Program and the International Field Assistance Specialization Program.

*IRS Restructuring and RRA 98:* RRA 98 provisions that affect examination programs are assigned to the Office of Corporate and Individual Income Tax for coordination with the owner function and other affected functions. The office has issued extensive guidance on various provisions.

In addition, the office has developed proposed guidance relating to the prohibition on ex parte communications that might compromise Appeals officers' independence. See Notice 99-50. It is important to emphasize that Congress has not prohibited all Appeals officer's communication with other IRS employees. What is prohibited is anything that "appear[s] to compromise the independence of the appeals officers." Appeals published the results of its efforts in Notice 99-50, which was published in the Oct. 4, 1999, Internal Revenue Bulletin.


### BUDGET

Appeals centrally provides training and handles national facilities and space issues for facilities outside the Beltway. Appeals has a centralized budget of almost \$175 million. It develops the budget for submission to the IRS, Treasury Department, Office of Management and Budget, and Congress. After receiving congressional approval, Appeals developed an allocation plan based on a detailed workload model, and is also responsible for the day-to-day operation of the budget nationally.

The Office of the National Director of Appeals is the direct focal point for Appeals' field and regional administrative personnel. Outside customers include the Comptroller's Office, Corporate Education, and other IRS administrative groups.

### DIRECTOR OF PRACTICE

Appeals also has the responsibility for developing and enforcing provisions of Circular 230, which sets forth the practice rules for those who represent taxpayers before the Internal Revenue Service. Appeals prepares and administers the Special Enrollment Examination for those who wish to be enrolled agents and, in addition, participate on the Joint Board for the Enrollment of Actuaries.

Appeals is responsible for the Power of Attorney Program. This includes responsibility for the Conference and Practice Requirements (26 D.F.R. Part 601) and the power of attorney form (Form 2848). Furthermore, Appeals reviews all administrative appeals in connection with the Electronic Filer Program. 

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# ADR Programs Are Set for Taxpayers' Use

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has a customer service representative in each of its 33 offices. See Announcement 99-98, 1999-42 I.R.B. 520, for a list of their duties and telephone numbers.

As stated in the accompanying article, in response to growing taxpayer interest, Appeals has established a number of ADR procedures intended to resolve tax disputes more effectively and efficiently. These procedures primarily are designed to identify particular issues in a case which, if resolved, could serve to bring the entire case to an expeditious conclusion.

### MEDIATION AND ARBITRATION

National Office Appeals is testing mediation as an extension of the Appeals process. The procedures allow taxpayers, whose cases are not docketed in any court and already are in the Appeals administrative process, to request mediation. Mediators can come from Appeals or outside the IRS; co-mediators also can be used.

The purpose of the mediation procedures is to attempt to resolve issues before cases are put on a court docket. Mediation is intended to apply only after good-faith negotiations in Appeals have been unsuccessful. Factual issues, such as valuation and transfer pricing issues, are appropriate for mediation.

Appeals has tested the use of mediation for Coordinated Examination Program cases assigned to Appeals team chiefs nationwide, generally those with proposed adjustments of \$10 million or more. [See accompanying article for more on Coordinated Examination Programs.] Announcement 95-86, 1995-44 I.R.B. 27, and Announcement 97-1, 1997-2 I.R.B. 62, contain the procedures that taxpayers previously used to request mediation.

In Announcement 98-99, 1998-46 I.R.B. 34, Appeals expanded the mediation test to allow taxpayers to request mediation for factual issues involving an adjustment of \$1 million or more that already are in the Appeals administrative process. The mediation procedure is effective for requests for mediation made during the two-year test period beginning on Nov. 16, 1998, the date Announcement 98-99 was published in the Internal Revenue Bulletin.

Additionally, Section 3465 of RRA 98, provides for expansion of mediation below the \$1 million threshold contained in Announcement 98-99. For these issues, Appeals is accepting requests for mediation on an ad hoc basis under RRA 98 until procedures for those issues are published.

Mediation is optional. A taxpayer and an Appeals team chief or Appeals officer may request mediation, after consultation with each other. The request is initiated by the taxpayer sending a written request seeking approval for mediation to the appropriate "Assistant Regional Director of Appeals-Large Case," with a copy to the National Director of Appeals. For cases assigned to an Appeals officer, the handling of the re-

quest will be expedited if the taxpayer also sends a copy of the mediation request to the Appeals officer and the appropriate Appeals associate chief.

Mediation may be available in the following cases:

- Early referral issues described in Rev. Proc. 99-28. See discussion below.
- Joint Committee cases, but any agreement will not be finalized until after Joint Committee review.

Appeals mediation cannot be used if the issue is:

- Designated for litigation or docketed before the U.S. Tax Court.
- An Industry Specialization Program issue or an Appeals Coordinated Issue. ISP issues are listed in Exhibit 8.7.1-1 of the Internal Revenue Manual and ACIs are listed in Exhibit 8.7.1-3 of the manual.
- A competent authority issue (see discussion below).

### NARROW ADR APPLICATION

The new alternative dispute resolution techniques tend to have narrow application, and it is helpful to review how they relate

Mediation  
requests are  
initiated by the  
taxpayer.

to each other. For example, the early referral and mediation procedures are generally not used to resolve issues for which the taxpayer has filed a request for competent authority assistance (see discussion below). This is because if a taxpayer enters into a settlement with Appeals (including an Appeals settlement through the early referral or mediation process), and then requests competent authority assistance, the U.S. competent authority will only attempt to obtain a correlative adjustment with the treaty country, and will not take any actions that would otherwise amend the settlement. Rather, taxpayers are encouraged to request the simultaneous Appeals/competent authority procedure.

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Taxpayers may be able to use the mediation procedures in conjunction with early referral, provided the early referral issue meets the mediation requirements. If early referral negotiations are unsuccessful in Appeals, taxpayers may then request mediation for the issue. By combining the two procedures, taxpayers could expedite their resolution. As noted above, taxpayers considering this option do not have income tax treaty considerations.

Characteristic of mediation, IRS mediators do not have settlement authority. But the parties indeed can agree to resolve the dispute with finality. Mediation is particularly useful for IRS cases that are highly factual, involving issues such as valuation, reasonable compensation or transfer pricing. Mediation facilitates communication and also enhances IRS services to taxpayers and tax practitioners.

### BEGINNING THE PROCESS

If the taxpayer and Appeals agree in principle to mediate one or more issues, the parties will prepare a concise, written agreement to mediate. Usually, the parties negotiate the agreement and select the mediators within two weeks. Announcement 98-99 contains a model agreement to mediate, with exhibits that can be used in the process. The IRS's experience is that the entire mediation process can be completed within 90 to 120 days.

Appeals and the taxpayer share the cost of the mediator's expenses, but if the parties select a mediator from Appeals, the National Office Appeals will assume all of the mediator's expenses. The taxpayer and Appeals can use any local or national organization that provides a roster of neutrals in selecting a mediator. Most mediation sessions are concluded in one day, and the parties can schedule two additional mediation sessions to follow the initial session, if needed.

At this writing, 38 mediation requests have been made. Twelve cases were concluded: nine were successfully resolved and three cases didn't resolve. Seventeen mediation cases are in process, and nine were denied because they did not meet the mediation criteria.

### BINDING ARBITRATION AT THE IRS

Internal Revenue Code Section 7123(b)(2) provides that the U.S. Treasury Secretary shall establish a pilot program under which a taxpayer and the Internal Revenue Service appeals office may jointly request binding arbitration on any issue

unresolved at the conclusion of (A) appeals procedures, or (B) unsuccessful attempts to enter into a closing agreement under section 7121 or a compromise under section 7122. The Administrative Dispute Resolution Act of 1996, Pub. L. No. 104-320, also encourages federal agencies to use all ADR techniques in the federal administrative process (including binding arbitration where warranted) to resolve disputes. See 5 U.S.C. section 575. Chief Counsel presently has a voluntary binding arbitration program for factual issues in docketed cases under Tax Court Rule 124, see Chief Counsel Directives Manual (35)3(17)1.

Appeals is developing procedures for a pilot program to test binding arbitration. This would allow taxpayers to request arbitration for factual issues that are already in the Appeals administrative process.

### EARLY REFERRAL

Section 7123 of the Internal Revenue Code provides that the Secretary of the Treasury shall provide procedures by which any taxpayer may request early referral of one or more issues from a tax examination or the Collection Division to National Office Appeals. Consequently, the early referral procedure has been expanded to allow for additional cases to be eligible for early referral. Early referral is no longer limited to the largest cases in the IRS's Coordinated Examination Program.

The early referral procedures allow taxpayers whose returns are under examination, to request the transfer of a developed, open issue to Appeals while the other issues in

the case continue to be developed in the district. The purpose of early referral is to resolve cases more quickly. The early resolution of a key issue may encourage taxpayers and the IRS to agree on other issues in the case. Early referral may save time because Appeals and the district are working simultaneously.

Revenue Procedure 99-28, 1999-29 I.R.B. 109, describes the procedures that allow taxpayers to request early referral of an issue from the examination or Collection Division to Appeals. The revenue procedure also contains special procedures for requesting early referral of one or more unresolved issues with respect to an involuntary change in method of accounting, employment tax, employee plans and exempt organizations. The early referral procedures have been used in more than 200 cases, involving more than \$10 Billion.

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The IRS  
has a model  
mediation  
agreement;  
the process can  
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in 90 to 120  
days.

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The following are some highlights of the early referral process set forth in Rev. Proc. 99-28:

- The district will advise the taxpayer of its decision to approve or deny the early referral request within 14 days of the date the request is received from the taxpayer. A taxpayer's early referral request no longer requires the concurrence of Appeals.
- Taxpayers can request an informal conference with the supervisor of the case or a group manager to discuss the district's denial of an early referral request.
- Regular Appeals procedures apply, including taxpayer conferences.

Appropriate issues for early referral include those that:

1. if resolved, can reasonably be expected to result in a quicker resolution of the entire case;
2. both the taxpayer and the district agree should be referred to Appeals early;
3. are fully developed; and
4. are part of a case where the remaining issues are not expected to be completed before Appeals could resolve the early referral issue.

Industry Specialization Program issues can be referred to Appeals for early resolution under the early referral procedures.

Early referral does not apply:

1. where a 30-day letter has been issued (see below). Thus, a qualified offer under Section 7430(c), may not be made as part of the early referral process because such offers may only be made subsequent to the issuance of a 30-day letter;
2. where an issue is not fully developed;
3. when the remaining issues in the case are expected to be completed before Appeals could resolve the early referral issue;
4. where an issue is designated for litigation by the IRS Office of Chief Counsel;
5. to an issue for which the taxpayer has filed or intends to file a request for competent authority assistance under an income tax treaty. The IRS Assistant Commissioner (International) assists taxpayers in resolving disputes that arise under U.S. income tax treaties. As the "U.S. competent authority," the Assistant Commissioner (International) will develop a position paper on the issue with the taxpayer and contact the foreign competent authority. The "simultaneous Appeals/competent authority procedure" is explained in detail below.

6. if a taxpayer enters into a settlement with Appeals (including an Appeals settlement through the early referral process), and then requests competent authority assistance, the U.S. competent authority will endeavor only to obtain a cor-

‘Early referral’  
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faster.

relative adjustment with the treaty country and will not take any actions that would otherwise amend the settlement; or

7. where the issue is part of a whipsaw transaction. The term "whipsaw" refers to the situation produced when the government is subjected to taxpayers' conflicting claims of taxpayers. A potential whipsaw situation exists whenever there is a transaction between two parties and differing characteristics of transactions will benefit one and hurt the other for tax purposes.

Early referral is, in short,

- Optional, requested by the taxpayer,
- Approved by the district, and
- No longer limited to Coordinated Examination Program cases.

### HOW TO REQUEST EARLY REFERRAL

Taxpayers initiate early referral on an open issue by making a request to the district. The district must concur for the request to be approved. Taxpayers request early referral in writing. The written request should

- be submitted to the case/group manager.

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- identify the taxpayer, tax period, and issue.
- request resolution of a specific open issue.
- fully describe the taxpayer's position with regard to the issue.

*Early referral and section 6621 (c) "hot" interest.* Early referral does not trigger additional interest charges, known as "hot" interest, under Section 6621(c). A Form 5701, Notice of Proposed Adjustment, or an equivalent form (the Notification Form) will be issued by the district on the early referral issue. Since the Notification Form is not a 30-day letter, there will be no "hot" interest until a 30-day letter is issued by the district at the completion of the examination.

If the district concludes its examination of any issues not referred as part of the early referral process, it will issue a preliminary notice of deficiency—the 30-day letter—with respect to open issues. The letter will include any issues referred under the early referral process that are still pending in Appeals at the time the examination is concluded. The issuance of the 30-day letter generally will constitute the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review for purposes of the increased underpayment rate of interest for large corporations as provided in section 6621(c), or for the award of administrative costs under section 7430(c).

If the only open issues present in the case at the time the examination is concluded are issues that were considered by Appeals under the early referral process and returned to the district without an agreement, no 30-day letter will be issued. Instead a statutory deficiency notice—a 90-day letter—will be issued. If a 90-day letter is issued instead of the 30-day letter, the 90-day letter will constitute the first letter of proposed deficiency for purposes of Sections 6621(c) and 7430(c).

Here's how this process coordinates with Appeals' mediation program: Section 2.16 of Rev. Proc. 99-28 provides that if early referral negotiations are unsuccessful and an agreement is not reached with respect to an early referral issue, taxpayers may then request mediation. The early referral issue must meet the mediation criteria. See Announcement 98-99, 1998-46 I.R.B. 34, and the mediation section above.

### SIMULTANEOUS APPEALS/ COMPETENT AUTHORITY PROCEDURE

The simultaneous Appeals/competent authority procedure encourages taxpayers to request competent authority assistance and the participation of Appeals while a case is under the Examination Division's jurisdiction. Revenue Procedure 96-13, 1996-1 C.B. 616, contains the competent authority procedures and supersedes Rev. Proc. 91-23, 1991-1 C.B. 534. Section 8 of Rev. Proc. 96-13 specifies the circumstances under which the simultaneous appeals/competent authority procedure may be requested and describes the role of Appeals.

*Advance pricing agreements.* The simultaneous Appeals/competent authority procedure is designed to be used in conjunction with a taxpayer's request for an advance pricing agreement, or APA, covering the prospective determination and

application of transfer pricing methodologies for international transactions. An APA is an agreement between the IRS and the taxpayer on the transfer pricing methodology to be applied to any apportionment of income, deductions or credits between two

If early referral  
doesn't work, mediation  
may be an option for  
resolving the case.

or more organizations owned or controlled by the same interests.

Rev. Proc. 96-53, 1996-2 C.B. 375, sets forth the advance pricing agreement procedures, and Section 8 provides new rules clarifying the treatment of APA rollback requests, and coordinating with accelerated competent authority resolution and simultaneous Appeals/competent authority consideration. See Section 7.06 of Rev. Proc. 96-13. This coordination would be necessary regarding the "gap years," i.e., tax years that are not covered by the APA request for which returns have been filed, but that are not under audit. Notice 98-65, 1998-52 I.R.B. 10, provides new APA procedures for small business taxpayers, who may also want to request the simultaneous Appeals/competent authority procedure. Appeals representatives have been involved in 34 APAs.

The simultaneous Appeals/competent authority procedure expedites the resolution of competent authority issues by en-

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## BUILDING A USER-FRIENDLY INTERNAL REVENUE SERVICE

# ADR Programs Are Set for Taxpayers' Use

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couraging taxpayers to request the participation of Appeals in the competent authority process. Section 8 of Rev. Proc. 96-13 specifies the circumstances under which the simultaneous Appeals/competent authority procedure may be requested, when access to the process may be denied or terminated, and describes the role of Appeals in the competent authority process if the request is approved.

The simultaneous Appeals/competent authority procedure includes the following:

- Taxpayers are encouraged to request a pre-filing conference with Appeals and the U.S. competent authority to explore using the procedure.
- Taxpayer involvement in the competent authority process.
- Post-competent authority procedures retaining rights to negotiate a settlement with Appeals.

*Scope of request:* Taxpayers may request the participation of Appeals in the competent authority process

- after the Examination Division has proposed an adjustment with respect to an issue which the taxpayer wishes to submit to competent authority.
- when a 30-day letter is issued by the Examination Division. The taxpayer can file a protest and decide to sever the issue and seek competent authority assistance while other issues are referred to or remain in Appeals; and
- after the taxpayer is in Appeals and it is evident that the taxpayer will request competent authority assistance on an issue.

The taxpayer also can request the procedure after a competent authority request is made. Generally, the request will be denied if the U.S. position paper has already been communicated to the foreign competent authority. The U.S. competent authority can also request the procedure. Taxpayers should address the request to the U.S. competent authority, who will have jurisdiction for the issue.

The simultaneous Appeals/competent authority program is a two-part process. First, the Appeals representative will prepare an Appeals case memorandum (ACM) on the issue. The ACM is shared with the competent authority rep-

resentative, but not with the taxpayer. The ACM is a tentative resolution that is considered by the U.S. competent authority in preparing the U.S. position paper for presentation to the foreign competent authority. The competent authority representative generally does not attend the Appeals conferences with the taxpayer to develop the ACM, but Appeals will coordinate development of the ACM with the U.S. competent authority.

Besides new ADR procedures, the IRS has set up new systems to monitor the agency's dispute resolution processes.

Second, the U.S. competent authority prepares and presents the U.S. position paper to the foreign competent authority. The U.S. competent authority meets with the taxpayer to discuss the technical issue to be presented to the foreign competent authority and the Appeals representative may be asked to participate. If the competent authorities fail to agree or the taxpayer does not accept the mutual agreement reached, the taxpayer is allowed to refer the issue to Appeals for further consideration. This procedure will not affect any taxpayer request for an Appeals conference on other unresolved issues. Fourteen simultaneous Appeals/competent authority cases have been completed and 20 other cases are in process.

### OTHER IRS ADR

RRA 98 provides ADR-like procedures in other areas. The law directs the IRS to modify its administrative procedures to allow bond issuers to get an administrative appeal of an adverse determination by the Employee Plans/Exempt Organizations Key District of the tax-exempt status of a bond

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## BUILDING A USER-FRIENDLY INTERNAL REVENUE SERVICE

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issue. Notice 98-58, 1998-49 I.R.B. 13 provided the interim procedures. RRA 98 requires that the appeals be heard by senior Appeals officers having experience in resolving complex cases. The appeal is optional and initiated by the issuer.


Early referrals are permitted under certain conditions during the bond examinations. And there are other Appeals ADR options that may be available. For example, factual issues concerning a bond issue may be appropriate for the Appeals mediation program, as noted in the mediation discussion above.

It's now easier for a taxpayer to rescind a Notice of Deficiency. In Revenue Procedure 98-54, I.R.B. 1998-43, 7. (Oct. 26, 1998), the IRS has clarified and modified the rules for entering into agreements to rescind a notice of deficiency. The modifications account for certain statutory amendments, allow rescission for taxpayers who agreed to extend the limitations period for assessment, permit the IRS to initiate rescissions, and allow the use of forms other than Form 8626, the Agreement to Rescind Notice of Deficiency.

Appeals also has developed a dispute resolution program to assist taxpayers in resolving IRS-related bankruptcy disputes. See Announcement 97-111, 1997-47 I.R.B. 15. Once the Collection Division takes enforcement action against a taxpayer, the taxpayer's recourse is often just filing for bankruptcy. The Bankruptcy Appeals Program provides an informal hearing with Collection, which, if not resolved, would then allow the taxpayer to move the dispute to Appeals for consideration. The program gives Appeals authority to reach agreement with taxpayers on bankruptcy issues.

### SYSTEMS ASSESSMENT

The alternative dispute resolution process being employed to develop these programs places great value on feedback from those who will be using the procedures. The process consists of first forming a working group of national office and field personnel to consider a new program; publishing a proposed dispute resolution procedure for public comment; holding a public hearing and then publishing a follow-up announcement that taxpayers can use during a test period. A revenue procedure is published at the end of the process after the test period, rather than being implemented at the beginning. Additionally, taxpayers can request pre-filing conferences with the national office and field personnel to discuss the application of the available dispute resolution procedures.

Appeals ADR initiatives offer prompt and less expensive methods for taxpayers to resolve their disputes after good-faith negotiations have failed in Appeals or agreement can't be reached with the examination. When any of these programs enable the taxpayer and the IRS to reach agreement, burdens and costs to both of them are reduced. 

## FEEDING BACK TO THE IRS

As part of its continuing evaluation of dispute resolution programs, the Office of the National Director of Appeals conducts customer satisfaction surveys to collect feedback from taxpayers about the Appeals process. Some of the recent findings are:

- 84% of respondents would use Appeals again.
- 70% completely or somewhat satisfied with Appeals fairness and impartiality.
- 70% completely or somewhat satisfied with the overall Appeals process.

(See Fact Sheet 98-15.)

The IRS announced in IR-98-7 that in a new series of surveys, taxpayers who have dealt with the IRS will be asked to complete questionnaires to rate the service they received. A private contractor is conducting the customer satisfaction surveys of all IRS functions.

The Office of Management & Budget recently approved an Appeals survey for its ADR programs. The IRS appreciates receiving feedback from its internal and external customers, especially about improving the ADR process.

For more information, see "IRS Initiatives to Resolve Disputes over Tax Liabilities," U.S. General Accounting Office, Report to the Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives, GAO/GGD-97-71 (May 1997); and "Building a Better Resolution: Adapting IRS Procedures to Fit the Dispute," by Thomas Carter Louthan and Steven C. Wrappe, *Tax Notes Today* (Nov. 18, 1996).

See also the IRS Internet Web site at [www.irs.gov](http://www.irs.gov) and the Appeals Web site at [www.irs.gov/prod/ind\\_info/appeals](http://www.irs.gov/prod/ind_info/appeals) or contact the author by E-mail at [tcclout00@m1.irs.gov](mailto:tcclout00@m1.irs.gov).

—Thomas Carter Louthan