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IRS Appeals: Making Your Way Through An Administrative Maze

by Amy E. Heit



For most, taxes are an inescapable fact of life. If there is one governmental agency everyone knows about, it is the Internal Revenue Service. For the majority of tax-paying individuals, contact with the IRS is generally limited to filing tax returns and obtaining refunds. However, for the "minority" of taxpayers who are subject to an audit (and do not agree with the examiner's findings), most will deal exclusively with the Appeals Division of the IRS, an administrative body which attempts to settle tax cases before they get to court.

By using state-of-the-art information technology, the IRS has developed the most sophisticated system of tax administration in the world. In 1985, for example, the IRS processed 178.2 million federal tax returns, conducted 1,458,746 audits and recommended additional tax and penalties on 1,104,161 returns.¹ Once a case is audited, the taxpayer can 1) pay the tax; 2) pay the tax, file for a refund, and if it is denied, file a petition in either the district

court or the claims court; 3) request a conference with an appeals officer and attempt to settle the case without litigation. Of the audited cases that were appealed in 1985, agreements were reached in 89.6% of the 26,866 cases that were docketed in the Tax Court and 84.9% of the 36,434 non-docketed cases (cases that came immediately to appeals without first being filed in the Tax, district, or claims court).²

The Nature of A Taxpayer's Appellate Rights

It has been said that the concept of an appeals procedure originates from the Due Process Clause of the Bill of Rights.³ The Fifth Amendment provides in part,

[N]o person shall be . . . deprived of life, liberty or property without due process of law.⁴

A governmental appropriation of revenue that is not within the bounds of the law constitutes a constitutional violation from

which a taxpayer's appellate rights are said to arise.⁵ The administrative appeals system intends to assure both procedural and substantive due process by providing taxpayers with a forum in which to settle tax disputes without having to go to court.

The government has consistently provided for an administrative appeal for taxpayers who did not agree with a proposed assessment. For example, the Act of 1789, which established the Treasury Department, provided that any person who was dissatisfied with an audit of his tax return had six months to appeal the examiner's findings. Similarly, the Act of 1796 provided a detailed system of appeals, with the last recourse for administrative appeals being the Secretary of the Treasury. The Revenue Acts of 1862 and 1864 gave the Commissioner authority to settle all internal revenue suits. Finally, in 1870, a taxpayer could file a direct appeal to the Commissioner after being audited. However, it was not until passage of the Revenue Act of 1913 that a formal appellate board came

into existence, and in 1924 the Board of Tax Appeals was created to act as an independent appellate entity, apart from collection and assessment. The Board of Tax Appeals became, in 1942, what is now known today as the Tax Court.

Ever since the creation of the Board of Tax Appeals in 1924, there has been an increasing number of audited returns. In order to help limit the number of cases that are litigated, the Service has provided taxpayers with opportunity to settle their cases before they go to court. It is the intent of this article to explain the appeals process as a means of by-passing the need to go to court.

The Appeals Process

So long as a genuine factual or legal tax question exists, a taxpayer has the right to an administrative appeal. A mere failure or refusal to comply with the tax laws "because of moral, religious, political, constitutional, or other similar grounds," will not afford a taxpayer the right to an appeal.⁶ Where an actual tax question exists, the administrative appeal is an excellent way of saving time and litigation costs. Also, preparation of a protest for an administrative conference provides a solid basis upon which to base an argument if the case should later go to court.⁷

The appeals process begins when a return is audited through an office or a field examination.⁸ An office exam may begin by either an IRS service center or by an IRS district office, depending on the complexity of the issues involved. Office exams initiated by service centers are generally conducted by correspondence. If an interview with the taxpayer or additional evidence is needed to support items claimed on the return, the district office will take over the proceedings. In field examinations, the IRS agent actually goes to the taxpayer's premises and examines the taxpayer's books and records.

Once an office or field examination is complete, the taxpayer will be furnished with the revenue agent's report (the RAR). Attached to the report will be a preliminary notice of deficiency (the 30-day letter) which gives the taxpayer thirty days to decide if he or she wants to proceed with an administrative appeal, send additional information, or pay the tax. "While the RAR and any accompanying transmittal letter are used by the agent to identify a proposed tax deficiency and the reasons therefore, the 30-day letter is a standard form letter and serves as the cover letter to the RAR in unagreed cases."⁹ If the taxpayer agrees with the examiner's findings, the taxpayer must sign and return the agree-

ment to the district office within fifteen days. If additional tax is owed, interest will stop accruing 30 days after the form is filed.¹⁰ The taxpayer's acceptance of the assessment does not prevent the taxpayer from paying the tax, filing a claim, and bringing a suit for a refund. Specifically, I.R.C. sec. 6532(a)(1) provides that a taxpayer has two years, beginning from the date of mailing of the notice of disallowance of the claim, in which to attempt to recover a refund.

An assessment by the IRS is *prima facie* correct, thus placing the burden on the taxpayer to disprove the findings by the IRS. When the 30-day letter is issued to the taxpayer, it is usually within the taxpayer's best interest to respond in the form of a written protest. Taking part in an appeals conference is completely voluntary

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and "generally is the one pre-litigation opportunity to question positions which . . . an agent has taken . . . with an [appeals officer] who has extremely wide settlement powers."¹¹ If the taxpayer chooses not to respond to the 30-day letter or pursue an administrative appeal, the IRS will issue a "notice of deficiency" (a 90-day letter) and process the case on the basis of the proposed adjustments. Once a 90-day letter is issued it cannot be withdrawn and the taxpayer must then file a petition in the Tax Court and contest the assessment or pay the tax, file a claim for a refund, and if the refund claim is denied, file suit in either the district or the claims court. If the taxpayer does not file a petition in the Tax Court within 90 days of the date of the notice of the deficiency, the taxpayer must pay the tax and file for a refund.

Filing a Protest

Though a written protest is not required in any office examination case or where the assessment is less than \$2,500,¹² a written protest can save time and help to clarify issues when a conference is finally held. Where the assessment is the result of a

field examination or the amount is above \$2,500, a protest must be written.

As a general rule, it is advisable to file a protest unless extraordinary circumstances dictate that a taxpayer go straight to Tax Court or pay the tax and institute a refund claim. A major reason for by-passing the protest procedure [may be] the concern that the appeals officer . . . may raise an issue which the examiner overlooked and which could create the possibility of an additional substantial tax liability.¹³

Though an appeals officer may raise issues which the agent overlooked, only substantial and material issues may be raised, and with regard to cases filed in the Tax Court, the burden is on the government to prove the additional issues.¹⁴

Another major advantage of filing a written protest with Appeals is that the filing will help to preserve the right to claim court costs if the case is ever litigated. While expenses incurred solely from taking an administrative appeal are not recoverable from the government, a taxpayer may be entitled to recover reasonable litigation expenses incurred, including court costs, expert witness fees, and attorney fees. In order to recover expenses,¹⁵ a taxpayer must:

- 1) substantially prevail in the case with respect to the amount or the issues;
- 2) show that the Government's position was unreasonable; and
- 3) exhaust all of the administrative remedies (i.e., filing a protest).

Technically, a written protest or a request for an appeals conference must be made within 30 days of the date of the preliminary notice of deficiency. In practice, however, a taxpayer can usually obtain an extension if the taxpayer or the taxpayer's representative has reasonable grounds to justify a delay and the request is made in the initial 30 day period.¹⁶ According to the IRS Audit Manual, an extension may be granted because:

- 1) more time is needed to prepare a meaningful protest where the taxpayer has chosen to represent him or herself;
- 2) a new representative is obtained;
- 3) the taxpayer or the representative is sick or injured; or
- 4) the issues are complex and require extensive research.

However, where a tax shelter case is involved, "current IRS policy is not to grant [an] extension of the 30 day period because of the tremendous backlog of tax-shelter cases."¹⁷ Also, if the statute of limitations

will expire within 150 days of the granting of an extension and the IRS will not have sufficient time to adequately process the case, an extension will be contingent on securing consent to extend the statute.¹⁸

General Requirement Of A Protest

The preparation of a thorough protest, one that contains a complete statement of the facts and the applicable law, provides the taxpayer with the opportunity to present information in the light most favorable to the taxpayer's position.¹⁹ A written request must include the following:

- 1) a statement that the taxpayer wants to appeal the findings of the examiner to the appeals office;
- 2) the taxpayer's name and address;
- 3) the date and symbols from the letter transmitting the proposed adjustments and findings that the taxpayer is protesting;
- 4) the tax period or years in question;
- 5) an itemized schedule of the adjustments with which the taxpayer does not agree;
- 6) a statement of facts supporting the taxpayer's position; and
- 7) a statement outlining the law or other authority relied upon.²⁰

The taxpayer or his or her representative is free to follow any format so long as all of the seven requirements are included in the protest. The statement of facts must be declared to be true under penalty of perjury. If the taxpayer's representative prepares the protest, the representative may substitute a declaration stating:

- 1) the representative prepared the protest and the accompanying documents; and
- 2) whether he or she personally knows that the protest and accompanying documents are true and correct.²¹

Preparing the statement of facts and law is similar to preparing a brief for a court of law.²² At times factual errors are made during an audit and it is up to the taxpayer to point out the pertinent facts. The presentation of the facts should be clear, concise and in chronological order. A taxpayer should include documents and other exhibits with the protest that will help to clarify the taxpayer's position. Also, "it is . . . important to make specific mention of facts that are similar to facts discussed in court cases where the court decided in favor of the taxpayer."²³

Likewise, it is important to include in

the statement which outlines the relevant law, well known cases, code sections, revenue rulings, and regulations on point. "The legal discussion should be specifically and directly related to the factual matters in the protest rather than being an abstract discussion of principles."²⁴ It is also important to include in the protest cases which may not be favorable to the taxpayer. Not only will the taxpayer be viewed as being more credible, but the taxpayer will then have the opportunity to distinguish the unfavorable cases and, in so doing, help to strengthen his or her own position.



One of the strongest arguments a taxpayer can make in his or her protest is that the revenue agent's conclusions are mistaken or misplaced. It may also be proper to attack a position taken by the IRS where the Service has lost a series of cases in several different forums.²⁵ Whether the taxpayer ultimately wins or loses depends on the particular facts involved and how the taxpayer presents them in the protest. The taxpayer's goal should be to show the appeals officer that, based on the relevant facts and law, the hazards of litigation are too great for the IRS to refuse to settle.

Settlement

The goal of the Appeals Division is to secure the "right answer." Often, however, there are no absolute right or wrong answers. "Taxpayers who request consideration of their case by the Appeals Division or who accept an invitation of the Appeals Division to discuss a possible settlement should not expect a settlement pulled out of the air."²⁶ A case involving a single issue is generally more difficult to settle than one that contains multiple issues. In addition,

cases that contain legal questions are more difficult to handle than those where questions of fact exist.

The settlement objective is to resolve tax controversies, without litigation, on a basis which is fair and impartial to both the Government and the taxpayer, and in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the Service.²⁷ The government realizes that the taxpayer will only turn to appellate review if the review is fair and objective; otherwise, the taxpayer will go to court and avoid wasting their time in Appeals.

There are three main types of settlements that are made: the mutual-concession settlement, the split-issue settlement and the partial settlement. The outcome of settlement negotiations depends on many factors, including the taxpayer's factual circumstance in light of code provisions, case law, revenue rulings and other precedent. Where there are substantial legal or factual uncertainties as to the correct application of the law to the questions involved, the appeals officer will accept a fair settlement offer made by the taxpayer.²⁸

The Mutual-Concession Settlement

Where it is substantially uncertain as to how 1) a court would interpret and apply the law, or 2) what facts the court would find, the government and the taxpayer can enter into a mutual-concession settlement. In such a settlement, both parties have substantial strength to their arguments and neither is willing to concede in full the unresolved area of disagreement.²⁹ In the interest of settlement and in order to avoid waiting for a court to make a decision (in which time interest on the assessment is accruing), both parties make concessions based on the relative strengths of the opposing position.

Split-Issue Settlement

A split-issue settlement is actually a form of a mutual-concession settlement. However, a split-issue settlement involves questions which, if litigated, would result in a decision completely for the government or the taxpayer.³⁰ The difference between a split-issue settlement and a mutual-concession settlement is that in a split-issue settlement, the agreed result would not be reached if tried. Under IRS policy, a split-settlement should be used "only where no other method of settlement is appropriate."³¹

Partial Settlements

Often cases that come to Appeals involve numerous issues. And, at times because of factual and legal uncertainties, issues do not lend themselves to be resolved at the appeals level. In cases where several issues are involved, it is the Service's policy to attempt to resolve as many issues as possible.³² Thus, even though a case cannot be resolved totally, when it does get to court the focus will be narrowed.

In any case, unresolved issues will not be disposed of simply because of "nuisance value."³³

Nuisance value is any concession that is made solely to eliminate the inconvenience or cost of further negotiations or litigation and is unrelated to the merits of the issues. Appeals neither exact a concession nor grant a concession solely to relieve either party of such inconvenience or cost.³⁴

The Golsen Rule

When an appeals officer reviews a case prior to negotiations, his or her main concerns include: what are the litigating hazards? How have previous taxpayers in factually similar cases held up in court? How strong is the government's position in light of the particular facts?

Another concern is whether the "Golsen Rule" applies.³⁵ In *Jack E. Golsen*, 54 T.C. 742 (1970), the Tax Court held that, where

the court of appeals to which [the] appeal [would lie], has already passed upon the issue before us, efficient and harmonious judicial administration calls for us to follow the decision of that court.³⁶ Thus, if a taxpayer's appeal is based on a conflict between a revenue ruling, revenue procedure, or other announcement of the Service's position and a decision by the court of appeals where the taxpayer's appeal would lie, the government must concede the issue.

Conclusion

The Appeals Division of the Internal Revenue Service provides an excellent forum for alternative dispute resolutions. The approach taken by appeals is one which attempts to reasonably appraise the facts, law and litigating prospects. Given the case load, the Service is under substantial pressure to settle cases. Generally, where the taxpayer takes the time to prepare a thorough protest settlement negotiations can be run more efficiently and litigation can be avoided.

Notes

¹1985 IRS Ann. Rep. 12.

²Id. at 34.

³[1986] Stand. Fed. Tax Rep. (CCH) para. 6000A (f)(1).

⁴U.S. Const. art. XIV, sec. 1.

⁵IRS Policy, P-8710-1.

⁶26 C.F.R., part 601.103 (1986).

⁷Zief, *Effective Preparation Of Protest Can Facilitate Settlement With The IRS*, Tax'n For Acc. 160 (March 1986).

⁸Treas. Reg. sec. 601.105(b)(2),(3).

⁹Zief, *supra* note 7, at 160.

¹⁰IRS Pub. 5 (Rev'd 8/84).

¹¹Zief, *supra* note 7, at 160.

¹²IRS Pub. 5 (Rev'd 8/84).

¹³Zief, *supra* note 7, at 161.

¹⁴IR Manual, 8743(5).

¹⁵IRS Pub. 5 (Rev'd 8/84).

¹⁶Sills & Geske, *Preparing An Effective IRS Protest: How To Win The Tax Case Without Going To Court*, Tax'n For Acc. 258 (October 1986).

¹⁷Zief, *supra* note 7, at 160.

¹⁸Sills & Geske, *supra* note 16, at 260.

¹⁹Id.

²⁰IRS Pub. 5 (Rev'd 8/84).

²¹Id.

²²Zief, *supra* note 7, at 161.

²³Id. at 162.

²⁴Sills & Geske, *supra* note 16, at 262.

²⁵Zief, *supra* note 7, at 163.

²⁶Mertens, *Law Of Federal Income Taxation* sec. 49.118 (1983).

²⁷IR Manual, 8711 (1).

²⁸See generally *id.*

²⁹IR Manual, 8712.

³⁰IR Manual, 8713.

³¹Id.

³²IR Manual, 8723.

³³IR Manual, 8714.

³⁴Id.

³⁵IR Manual, 8722(4).

³⁶54 T.C. at 757.

Amy E. Heit is the Articles Editor of the *Law Forum* and will be graduating in May, 1987.

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