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Life Cycle of a Federal Tax Controversy

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Welcome

Anticipating a Controversy

- When taxpayers enter into tax-sensitive transactions, it is important to anticipate audit risks when communicating and documenting the transaction. Participants in the transaction should avoid generating an “audit roadmap” for the IRS to follow should the transaction later come under scrutiny.
- Most business documents cannot be protected as confidential, but limited privileges and protections apply (discussed on the next slide)
- Appropriate document retention policies should be established and followed to maintain any applicable privileges or protections and to avoid the possibility of “spoliation” should litigation ensue.

Privilege Considerations

- Sources of privilege/protection
 - Attorney-Client Privilege
 - Work Product Doctrine
 - Section 7525 Tax Advice Privilege
- IRS “Policy of Restraint” – may limit requests from IRS to review tax accrual workpapers (e.g., FIN 48)
 - This is merely a policy position of the IRS; it is not an enforceable right to protection from disclosure. The question of what privileges apply to, or may be waived by, tax accrual workpapers has been extensively litigated.
- Waiver
- *Kovel* arrangements

Pre-Audit

- Proactive tax controversy management can be an efficient means of resolving potential tax disputes.
- Taxpayers may wish to obtain certainty prior to filing a tax return.
 - Pre-filing Agreements
 - Private Letter Rulings
 - Advance Pricing Agreements
 - Compliance Assurance Process
- When filing a return, taxpayers may wish to protect against the potential imposition of accuracy-related penalties by disclosing the tax treatment of an item using Form 8275, Form 8275-R, or Schedule UTP.
- Taxpayers with known or foreseeable tax exposures may wish to avoid confrontation with the IRS by engaging in certain processes before the IRS issues an audit notice.
 - Qualified Amended Return
 - Voluntary Disclosure and Relief Request Programs

Audit Management

- The IRS's examination and enforcement powers are extremely broad. All audits should be taken seriously. A good working relationship with the revenue agent is almost always beneficial to a taxpayer.
- If the IRS has issued an audit notice, taxpayers should consult with advisors as soon as possible to develop an audit defense strategy.
 - Identify any sensitive tax issues (self audit)
 - Is this a so-called "Eggshell Audit" involving the possible assertion of criminal liability?
 - Identify any affirmative claims
 - Negotiate the scope, location, and timing of the audit with the IRS
 - Designate persons to whom the IRS can direct requests
 - Institute tight controls regarding the flow of information
- There are two sometimes competing goals of an audit defense strategy.
 - Convincing the revenue agent to respect the tax return, as filed.
 - Positioning the taxpayer for success at IRS Appeals or in litigation.
- Revenue agents do not have the authority to settle novel legal issues based on a hazards of litigation assessment, absent a delegation of authority from IRS Appeals. However, revenue agents do have the authority to raise or not raise issues, giving them some *de facto* settlement authority.

Audit Management (cont'd)

- Responding to Information Document Requests (IDRs)
 - Reviewing draft IDRs
 - Limiting the scope of burdensome or irrelevant requests
 - Thinking strategically about *all* information provided to the IRS
 - Seeking extensions and avoiding the IRS's delinquency and summons enforcement options
- Producing legal opinions and claiming privilege
- Preparing for employee interviews and taxpayer presentations
- Elevating legal issues
 - Revenue agents can seek Field Advice from IRS Chief Counsel field attorneys without any input or knowledge of the taxpayer. Revenue agents are not required to follow Field Advice but, in practice, almost always do.
 - Either the taxpayer or the revenue agent can ask for Technical Advice from the IRS National Office in the form of a TAM. Taxpayers get to be involved in this process, but TAMs can take longer. TAMs are binding on a revenue agent.
- Extending the statute of limitations
 - Form 872 and 872-A
 - Restricted Consent

Audit Management (cont'd)

- Concluding the Examination Process
 - Draft Notice of Proposed Adjustment (NOPA)
 - Pros and cons of providing feedback on the IRS's positions
 - Revenue Agents' Report (RAR) and 30-day Letter
 - Taxpayers have 30 days (or 90 days in the case of large businesses) to agree with the proposed adjustments, protest the proposed adjustments with IRS Appeals, or do nothing
 - "Hot interest" begins running from this date
 - Statutory Notice of Deficiency (90-day Letter)
 - If the taxpayer does not respond to the 30-day letter, the IRS will issue a "stat notice." The taxpayer then has the right to file a petition in the Tax Court or pay the deficiency and file a refund claim in federal district court or the Court of Federal Claims.
- Fast-Track Settlement
 - A streamlined, non-binding mediation program that permits specific unagreed issues to be resolved in a one-day mediation session chaired by an IRS mediator from the Appeals Division. The process is much quicker than Appeals and requires less preparation. Mediators have settlement authority that revenue agents lack.

The IRS Appeals Process

- The majority of unagreed tax audits proceed to the IRS Appeals Division. The majority of tax disputes protested to Appeals are resolved without further proceedings.
- Participating in Appeals is usually beneficial to taxpayers, although taxpayers may wish to skip the Appeals process and proceed directly to litigation in some circumstances, e.g., to avoid delay in the ultimate resolution of the dispute, to deny the IRS additional time to develop its position, or to prevent the Appeals Officer from identifying new issues not raised on audit.
- Appeals maintains independence from the audit function. Appeals officers are generally barred from participating in “ex parte” communication with the revenue agent without the taxpayer present.

The IRS Appeals Process (cont'd)

- The Appeals process commences following the issuance of a 30-day letter with which the taxpayer does not agree.
- A taxpayer wishing to participate in Appeals files a “Protest” setting forth its disagreements with the RAR. The Protest is typically a detailed document that raises any and all factual and legal errors made by the revenue agent, although a “skeletal” Protest is acceptable.
 - The revenue agent will then issue a “Rebuttal” in which it concedes or rejects the taxpayer’s Protest arguments.
- Before settlement negotiations begin in earnest, a Pre-Appeals Conference is held at which the taxpayer and the revenue agent each present their summary of the issues to the Appeals team.
- Appeals is not intended to be another phase of the audit. Appeals officers may not raise new issues not identified by the revenue agent unless the ground for opening the issue is substantial and the potential effect upon tax liability is material.

The IRS Appeals Process (cont'd)

- The meat of the Appeals process takes place at Appeals Conferences. These conferences are sometimes face-to-face meetings but increasingly are held as telephone conferences or through written correspondence.
- Issues may be resolved through a single conference or may require multiple conferences. In addition, Appeals officers frequently request that taxpayers make additional submissions addressing their questions.
- Appeals officers are tasked with resolving cases on the basis of litigating hazards.
 - A single issue may be resolved through mutual concessions (i.e., with the taxpayer and the IRS each conceding a portion of the proposed adjustment) or entire issues may be conceded by each side as part of an overall settlement.
 - Appeals is not supposed to reach “nuisance” settlements where one side has less than a 20% chance of success. In such a case, the issue should be conceded entirely.

The IRS Appeals Process (cont'd)

- The Appeals process generally concludes by reaching an agreement as to some or all of the issues.
- In most cases, the taxpayer and Appeals will execute a Form 870-AD to close out the case. This form waives the restrictions on assessment and allows the IRS to assess the tax agreed to at Appeals. In addition, the form contains a pledge by both parties not to reopen the case. A Form 870-AD is typically respected by the IRS but does not have binding effect under the Internal Revenue Code.
- If some, but not all, issues have been agreed through Appeals, and the taxpayer wishes to litigate the remaining issues, taxpayers will either (i) settle the case but reserve specified unagreed issues for litigation in the Form 870-AD (in the case of refund litigation) or (ii) identify only the issues that have been resolved at Appeals on the Form 870-AD and leave the rest of the case open (in the case of Tax Court litigation).
- In some cases, a Form 906 closing agreement is preferable. A closing agreement is a contract that will bind the parties under contract principles and under the Internal Revenue Code.

Administrative Appeals - Dispute Resolution Options

- Early Referral to IRS Appeals
 - Certain taxpayers can ask the revenue agent to refer developed, unagreed issues to Appeals while the revenue agent continues to audit other issues.
- Administrative Appeals
 - The IRS Appeals Division has existed since 1927. The mission is to resolve tax controversies without litigation. Appeals serves an independent, quasi-judicial function. Appeals Officers have broad settlement authority.
- Post-Appeals Mediation
 - For certain cases where Appeals settlement discussions are unsuccessful regarding a narrow set of issues, taxpayers can request optional, non-binding mediation to assist with settlement negotiations.
- Appeals Arbitration
 - When limited factual issues remain unresolved following Appeals, optional binding arbitration is available.

Tax Litigation

- Where administrative dispute resolution proceedings have failed, or where taxpayers prefer to proceed straight to federal court, taxpayers may litigate their tax case.
- There are two main types of tax litigation
 - Refund Litigation in Court of Federal Claims and U.S. District Courts (where taxpayers must first pay the tax and then sue the government for a refund)
 - Department of Justice is opposing party
 - New issues not previously raised on audit can only be raised as an offset to the amount claimed as a refund (i.e., additional tax deficiencies cannot result)
 - District courts are sometimes viewed as more friendly “home turf”
 - Must be careful not to run afoul of the Variance Doctrine for refund claims
 - U.S. Tax Court (where taxpayers may contest a statutory notice of deficiency without first paying the tax)
 - IRS is opposing party
 - New issues not previously raised on audit may be raised by the IRS as a “new matter” and can result in additional tax liability
 - Some taxpayers fear that Tax Court is more friendly to the government
- Forum Selection Considerations
 - Applicable precedents (but consider the *Golsen* rule in Tax Court)
 - Attitude and approach of the judges – Tax Court judges are tax specialists while district court judges are generalists who do not frequently preside over tax cases. Court of Federal Claims judges hear only claims filed against the U.S. government, including many tax claims.
 - Tax Court and Court of Federal Claims cases are bench trials decided by a judge, while jury trials are available in district courts
 - Facts must be stipulated in Tax Court and discovery is limited compared to district courts and the Court of Federal Claims
 - Greater limitations on trial witness subpoenas in district court than in Tax Court and Court of Federal Claims

Tax Litigation (cont'd)

- Managing discovery/fact stipulations
- Pre-trial motions
- Settlement discussions
- Trials, post-trial motions, and appeals



Other Tax Controversies

- Collections
- Competent Authority Procedures
- Mandatory Arbitration under Tax Treaties

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