



The Inside Scoop About the IRS's Appeals Division

By David M. Fogel, CTA, CPA

Most tax practitioners know that if the Internal Revenue Service audits a client's tax return and the client disagrees with the results of the audit, the case may be appealed to the IRS's Appeals Division where a more favorable settlement may be achieved. But do you know what process the Appeals Officers go through to arrive at the settlements? Understanding the process, the personnel in the Appeals Division (and their expertise), and following some common-sense rules will enable you to better represent your clients in the Appeals process and perhaps lead to more favorable settlements.

History of Appeals

Now celebrating its 75th anniversary, Appeals' primary responsibility has been to facilitate and expedite the settlement of tax disputes without formal trial. Indeed, its mission has always been "to resolve tax controversies, without litigation, on a basis which is fair and impartial to both the Government and the taxpayer in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the Service."¹

Historically, Appeals has been able to settle the vast majority of the cases that come within its jurisdiction (around 90 percent). Appeals cases fall into two major categories — nondocketed and docketed. Nondocketed cases typically involve an administrative protest filed by the taxpayer in response to the examiner who initially considered the taxpayer's case (e.g., Revenue Agent, Revenue Officer). The taxpayer's protest is typically followed by one or more conferences with the taxpayer or the taxpayer's representative, during which the parties attempt to reach resolution of the issues in dispute. Docketed cases involve disputes where the taxpayer has filed a petition in the U.S. Tax Court contesting the IRS's notice of deficiency. After filing the petition, taxpayers who have not previously met with Appeals generally are allowed an opportunity to resolve the matter with Appeals before the case goes to trial². In both types of disputes, Appeals has broad authority to negotiate settlements by applying a "hazards of litigation" standard.

To accomplish its mission, the Appeals function must be fair and free of conflict of interest. This is done by separating Appeals Officers³ from compliance personnel (e.g., Revenue Agent, Revenue Officer). In fact, once a case is assigned to an Appeals Officer, he or she is prohibited from discussing the merits of the issues with the compliance employee⁴.

Appeals' Personnel

A typical Appeals office consists of one or more groups of Appeals Officers, each group supervised by an Appeals Team Manager. Appeals' support staff usually include Appeals Records and Processing personnel who handle the flow of cases and maintain administrative records, and Tax Computation Specialists who prepare computations for settled cases, notices of deficiency, Rule 155 decisions, re-

fund litigations, etc. In addition, there may also be secretaries, computer specialists, international specialists, or industry specialization program coordinators, reviewers and analysts.

Appeals personnel are among the most dedicated and most technically proficient individuals within the IRS. Unlike other parts of the IRS, Appeals Officers are not hired "right off the street." They must work themselves up through the ranks. To be Appeals Officers, they must establish that they have (1) the skill in interpersonal relations and the ability to conduct conferences in an orderly, fair, and impartial manner to resolve tax disputes, and (2) the technical expertise needed to understand a wide variety of tax issues. Appeals Officers are usually senior Revenue Agents or Revenue Officers who have demonstrated that they resolve most of their cases on an agreed basis. (Note: Within Appeals, former Revenue Agents are designated Appeals Officers, whereas former Revenue Officers are designated Settlement Officers. Both will be referred to as Appeals Officers herein.)

The Appeals Process

When Appeals receives each case, the file will generally include a protest, the examiner's report, the examiner's workpapers, correspondence, and other relevant papers. In docketed cases, it will also include the notice of deficiency, the petition filed with the Tax Court, and the Government's answer to the petition. If a protest was filed, the examiner will usually prepare a rebuttal.

For each issue in dispute, the Appeals Officer will review the file, determine if any additional documents or information are necessary, and will formulate a range of settlement that is appropriate. To discuss the issues, the Appeals Officers will then usually schedule an informal conference with the taxpayer or representative.

How Do Appeals Officers Reach a Settlement?

Traditionally, Appeals Officers settle cases either based on an analysis of the facts and/or the law, or due to "hazards of litigation." Most Appeals Officers use the "facts and law" approach to settle cases. Under this approach, to reach a settlement on a particular issue, an Appeals Officer typically will go over the facts, develop additional relevant facts, conduct an analysis of the law, and apply the facts to the law to reach a conclusion. Most Appeals Officers prefer to use this approach because it is easier to quantify the settlement and it is more tangible than the "hazards of litigation" approach.

What is a "hazards of litigation" settlement? Incredibly, Appeals' own manual (Part 8 of the Internal Revenue

Manual) doesn't define the term "hazards of litigation" or explain what a "hazards of litigation" settlement is⁵. Instead, it states that, "A fair and impartial resolution is one which reflects on an issue-by-issue basis the probable result in event of litigation, or one which reflects mutual concessions for the purpose of settlement based on relative strength of the opposing positions where there is substantial uncertainty of the result in event of litigation."⁶

"Hazards of litigation" in Appeals has generally become known as the probability that a party will lose the issue if it were litigated. After evaluating the facts and law, the Appeals Officer will formulate an opinion as to what the likely outcome will be in the event of litigation. While most compliance personnel tend to view issues in terms of black and white/right or wrong, most Appeals Officers tend to view issues in terms of shades of gray. Given that cases usually involve unique facts and that not all courts or judges apply the law uniformly, the litigating hazards for any particular issue may vary greatly from case to case, or even from Appeals Officer to Appeals Officer. In addition, the taxpayer or representative and the Appeals Officer may have completely different views of the litigating hazards involved. The best that they may be able to do is to agree upon a range for settling the particular issue.

Appeals Officers may enter into either "mutual-concession settlements" or "split-issue settlements." A "mutual-concession settlement" is one in which there is uncertainty as to what facts the courts would find or how the courts would interpret and apply the law⁷. An example is where the parties agree that 40% of a taxpayer's claimed travel and entertainment expenses represent valid business expenses where the taxpayer has satisfied the substantiation requirements of Code section 274(d). A "split-issue settlement" is one in which the parties agree to settle the case based on a percentage of the tax in dispute because no other method of settlement is appropriate⁸. It may involve a "trading" of issues or a "bottom line" settlement, and usually will require a closing agreement.

What do you do if you believe the Appeals Officer's evaluation of the litigating hazards is wrong? Hopefully, by distinguishing your client's facts from the facts in relevant case precedents and rulings adverse to your client, or by digging up such precedents and rulings that support your client's position, you will be able to show the Appeals Officer that there is a range of settlement that is acceptable and that your settlement proposal is within that range.

In addition, while tax audits tend to be document-intensive, representatives sometimes forget that their client's testimony may be an important element. Oral testimony is a central part of the total evidence in any litigation, and Appeals Officers are required to give great weight to such testimony if it is unrefuted, credible, probable, believable and reasonable⁹. If you believe that your client's testimony is crucial to an issue, then bringing the client to the conference or submitting his or her affidavit can be a powerful tool. But before deciding whether to bring your client to the conference, make sure that he or she is a credible witness and is well-prepared to answer any possible questions that the Appeals Officer might ask.

"Do's and Don'ts" For Practice in Appeals

Here is a handy list of "do's and don'ts" which may enable you to better represent your clients in the Appeals process and perhaps lead to a more favorable settlement:

- **Write a good protest.** The Appeals Officer will appreciate a well-written protest that lays out the facts in chronological order, and which logically sets forth the legal arguments, along with supporting authorities, e.g., case precedents. After settling the case, an Appeals Officer is required to write an Appeals

Case Memo to convince his or her supervisor (usually an Appeals Team Manager) to approve the settlement¹⁰. Having a written document from which to write the Appeals Case Memo makes the Appeals Officer's job easier.

- **Make sure you've presented all relevant evidence to the examiner.**

Some tax practitioners believe that they will achieve better settlements if they withhold some evidence from the examiner and present it to Appeals. They believe that the Appeals Officer will not scrutinize the evidence as

carefully as an examiner. However, by engaging in this practice you will not only damage your credibility at Appeals, but you will also delay the proceedings. Appeals Officers are required to give the examiner an opportunity to review and comment upon any significant new information or evidence presented by a taxpayer¹¹. Where it appears that the evidence was purposely withheld from the examiner, Appeals is required to release jurisdiction¹² and return the case to the examiner.

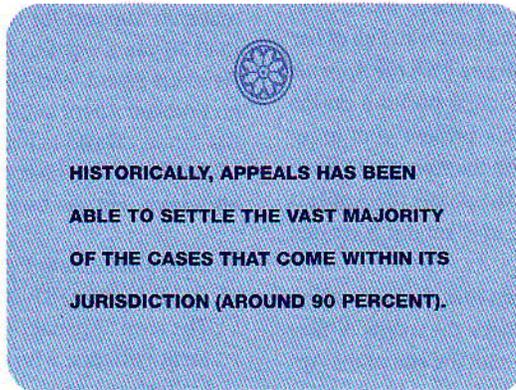
- **Obtain a copy of the examiner's rebuttal to the protest.** Before discussing the case with the Appeals Officer, you should request a copy of the examiner's rebuttal because it may provide useful information about the examiner's position on the issues in dispute.

- **Request a face-to-face conference with the Appeals Officer.** Appeals Officers tend to be less flexible if the case is handled entirely by correspondence or over the telephone. Face-to-face meetings put more pressure on the Appeals Officers to be reasonable and to find mutually acceptable settlements.

- **In scheduling a conference, be as flexible as possible.** Don't engage in negotiations over the date and time for the conference. After all, you requested the conference in your Protest. Appeals Officers believe that if you want to have such a conference, you'll adjust your schedule accordingly.

- **It is better to reach settlements with the Appeals Officers rather than the IRS attorneys.** IRS attorneys are a little too eager to try a case once it reaches the point where they have started to prepare for trial¹³. Therefore, you will usually obtain more favorable settlements from the Appeals Officers.

- **Don't request a different Appeals Officer.** If you have had difficulties with a particular Appeals Officer in the past, and a new case is assigned to that same Appeals Officer, you probably don't want to deal with him or her again. Except in excep-



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tional circumstances, you don't have the right to request another Appeals Officer¹⁴. Instead, change *your* attitude and conference practices to try to work with the Appeals Officer in reaching a mutually acceptable settlement.

- **Don't ask to record the conference.** Although you have the right to conduct an audio recording of Appeals conferences¹⁵, by doing so you will stifle virtually any chance of settling the case. Audio recordings will prevent the free and open discussion that is necessary for the parties to reach settlements.

- **Never insult the Appeals Officer or be disrespectful towards him or her.** You want the Appeals Officer on your side. You'll catch more flies with honey than with vinegar if you treat the Appeals Officer with respect and are pleasant in your dealings with him or her.

- **During the conference, don't argue with the Appeals Officer.** Instead, listen to the Appeals Officer's position on the issue and the points made. If you disagree, present your arguments tactfully and gently. Don't argue with the Appeals Officer. Rather, state that you want to think about the points the Appeals Officer has raised, then do your research, and submit a written rebuttal a few days or a week later.

- **If you want to raise new issues, do so at the first conference.** Appeals Officers are required to consider the merits of new issues raised by taxpayers¹⁶. But don't wait until the end of the Appeals process to raise any new issues, as this will be viewed as a negotiation tactic and will cast suspicion on the merits of the new issues.

- **Don't try to raise issues that are outside Appeals' jurisdiction.** Many practitioners try to negotiate the amount of interest that may be due on the deficiency, or they try to get the Appeals Officer involved in matters that are outside of Appeals' jurisdiction for the case under consideration. There are separate rules for disputing these matters that you should follow.

- **Have a settlement in mind before the conference and if appropriate, offer it.** Appeals Officers appreciate taxpayers or representatives who "get down to brass tacks" rather than spend months wrangling or haggling over issues. But don't offer nuisance value settlements: Appeals Officers are required to reject them¹⁷.

- **If the Appeals Officer requests additional documents or information, provide it promptly.** There are two reasons for this. First, by doing so, you demonstrate to the Appeals Officer that you desire to resolve the case quickly. The second reason is that it shows cooperation. If you take a long time to provide the documents and information, this could be viewed as a lack of cooperation and prevent you from shifting the burden of proof to the IRS if you are unable to reach a settlement and end up in litigation¹⁸.

- **Never negotiate issues in connection with the Appeals Officer's request to extend the statute of limitation.** To protect the Government's interest in a non-docketed case, Appeals Officers are required to solicit consent to extend the statute of limitation¹⁹. Under local procedures, this usually occurs 5 to 6 months before the statute of limitation is due to expire. You should never try to get Appeals Officers to concede issues in exchange for agreeing to sign the consent.

- **Don't use a "loser" issue as leverage.** In most cases, there will be undisputed adjustments in the examiner's report. You should not attempt to use your concession of these undisputed issues as leverage to persuade the Appeals Officer to concede disputed issues. You will fare better in Appeals if you concede the undisputed

issues either in the Protest or at the first Appeals Conference. This will strengthen your credibility with the Appeals Officer.

Conclusion

By understanding the Appeals process and by following a few common-sense rules, you will be better able to represent your clients in Appeals, and perhaps attain more favorable settlements for them.

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¹ Policy Statement P-8-1.

² See Rev. Proc. 87-24, 1987-1 C.B. 720.

³ The term "Appeals Officer" used in this article includes Settlement Officers, who are Appeals personnel who specialize in Collection cases.

⁴ Such a discussion would constitute an *ex parte* communication, which is prohibited to the extent that it appears to compromise the independence of Appeals. See Rev. Proc. 2000-43, 2000-43 I.R.B. 404.

⁵ The Appeals Manual uses the terms "hazards of litigation" and "litigation hazards" in several places, but never defines these terms.

⁶ Internal Revenue Manual section 8.6.1.3(2).

⁷ *Id.*, section 8.6.1.3(1).

⁸ *Id.*, section 8.6.1.3.2(1).

⁹ A taxpayer's unrefuted testimony may satisfy his or her burden of showing error in the government's notice of deficiency if such testimony is found to be credible, probable, believable and reasonable. *Demkowicz v. Commissioner*, 77-1 USTC ¶9318, 551 F.2d 929, 931 (3rd Cir. 1977); *Loesch & Green Construction Co. v. Commissioner*, 54-1 USTC ¶9261, 211 F.2d 210, 212 (6th Cir. 1954). However, such testimony may not satisfy that burden if it is irresponsive, uncorroborated, unreliable, unreasonable or questionable. *Lovell and Hart, Inc. v. Commissioner*, 72-1 USTC ¶9273, 456 F.2d 145, 148 (6th Cir. 1972); *Geiger v. Commissioner*, 71-1 USTC ¶9333, 440 F.2d 688 (9th Cir. 1971); *Baird v. Commissioner*, 70-1 USTC ¶9705, 438 F.2d 490, 493 (3rd Cir. 1970).

¹⁰ Internal Revenue Manual section 8.12.1.2.

¹¹ *Id.*, section 8.2.1.2.2(2).

¹² *Id.*, section 8.2.1.2.2(3).

¹³ See Burgess J.W. Raby and William L. Raby, "Tax 20 Forum: Quantifying Hazards of Litigation," *Tax Notes Today*, Tax Analysts (October 16, 1997).

¹⁴ Internal Revenue Manual section 8.6.1.2.6.

¹⁵ *Id.*, section 8.6.1.3.5.

¹⁶ *Id.*, section 8.6.1.4.4.

¹⁷ *Id.*, section 8.6.1.3.3. Appeals Officers are similarly not allowed to offer a nuisance value settlement.

¹⁸ See Code section 7491(a)(2)(B).

¹⁹ Internal Revenue Manual section 8.2.1.3.3.