

The Inside Scoop About the IRS's Appeals Division

by David M. Fogel

David M. Fogel, CPA, offers some helpful advice for practitioners on dealing with the IRS Appeals Division.

Date: Jun. 2, 2003

Full Text Published by **taxanalysts™**

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 could be achieved. But what process does the Appeals Officer go through to arrive at the settlement? Understanding the process, the personnel in the Appeals Division (and their expertise), and following some common-sense rules will enable tax practitioners to better represent their 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.¹ 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."²

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 or Revenue Officer).³ 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 trial.⁴ In both types of disputes, Appeals has broad authority to negotiate settlements by applying a "hazards of litigation" standard.⁵

To accomplish its mission, the Appeals function must be fair and free of conflict of interest.⁶ This is done by separating Appeals Officers⁷ from compliance personnel (e.g., Revenue Agent or Revenue Officer). In fact, once a case is assigned to an Appeals Officer, he or she is generally prohibited from discussing the merits of the issues with the originating compliance employee.⁸

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, refund litigations, etc. In addition, there may also be secretaries, computer specialists, international specialists, 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 up through the ranks. To be Appeals Officers, they must establish that they have (1) the skill in personal relationships 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.⁹ Appeals Officers are usually senior Revenue Agents or Revenue Officers who have demonstrated that they resolve most of their cases on an agreed basis.

The Appeals Process

When an Appeals Officer receives a 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. The Appeals Officer will then usually schedule an informal conference with the taxpayer or representative to discuss the issues in dispute.

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 their 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 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 is.¹⁰ 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."¹¹

"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.¹² While most compliance personnel tend to view issues in terms of "black and white," most Appeals Officers tend to view them 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 a 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 settlement.

Appeals Officers may enter into either "mutual-concession settlements" or "split-issue settlements."¹³ A "mutual-concession settlement" is one where there is uncertainty as to what facts the courts would find or how the courts would interpret and apply the law.¹⁴ An example is where there is doubt as to whether the client's records for travel and entertainment expenses satisfy the substantiation requirements of section 274(d), so the parties agree on a settlement where 50 percent of the deduction claimed is allowed. A "split-issue settlement" is one in which the parties agree to settle the case based on a percentage of the tax in dispute where no other method of settlement is appropriate.¹⁵ It may involve a "trading" of issues or a "bottom line" settlement, and usually will require a closing agreement.¹⁶ An example is where due to the complexity of an issue that involves several deductions, credits, and alternative minimum tax, the parties agree to settle on 75 percent of the proposed tax deficiency.

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

Here is a list of practical "do's and don'ts" that may enable tax practitioners to better represent their 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 sets forth the legal arguments logically with supporting authority such as 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 settlement¹⁷. Having a written document from which to write the Appeals Case Memo makes the Appeals Officer's job easier.

Make sure all relevant evidence has been presented to the examiner. Some tax practitioners believe that they will achieve a better settlement 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 they will not only damage their credibility at Appeals, but 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 taxpayer.¹⁸ Where it appears that the evidence was purposely withheld from the examiner, Appeals is required to return the entire case and release jurisdiction.¹⁹

Obtain a copy of the examiner's rebuttal to the protest. Before discussing the case with the Appeals Officer, 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. A face-to-face meeting puts more pressure on the Appeals Officer to be reasonable and to find a mutually acceptable settlement.

In scheduling a conference, be as flexible as possible. Some tax practitioners believe it is necessary to negotiate over the date and time for the conference as this sets the stage for subsequent negotiations. This is generally bad practice. Since, in the protest, the taxpayer or the representative requested an Appeals conference, Appeals Officers believe that it is the taxpayer or representative that should adjust their schedules accordingly.

It is better to reach a settlement with the Appeals Officer rather than the IRS attorney. IRS attorneys are a little too eager to try a case once it reaches the point where they have started to prepare for trial.²⁰ Therefore, a more favorable settlement for the client will usually be obtained from the Appeals Officer.

Don't request a different Appeals Officer. Some tax practitioners have had difficulties with a particular Appeals Officer in the past, and when a new case is assigned to that same Appeals Officer, they want the case reassigned. Except in exceptional circumstances, there is no right to request another Appeals Officer.²¹ Instead, the tax practitioner should change his or her 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 taxpayers have the right to conduct an audio recording of an Appeals conference,²² by so doing, any chance of settling the case virtually will be eliminated. An audio recording will prevent the free and open discussion that is necessary for the parties to reach a settlement.

Never insult the Appeals Officer or be disrespectful towards him or her. The Appeals Officer is a human being trying to accomplish a difficult job -- to reach a settlement on a case where the parties have opposing views. He or she is in a quasi-judicial position with no particular axe to grind in the dispute.²³ In most cases, treating the Appeals Officer with respect and being pleasant will achieve the best possible settlement for the client.

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. Disagreements should be presented tactfully and gently. Don't argue. Rather, ask the Appeals Officer for time to think about the points that have been raised, then conduct research and submit a written reply a few days or a week later along with legal authority supporting the client's position. Some tax practitioners believe that arguing with the Appeals Officer is how a settlement is negotiated; however, negotiating and arguing are not synonymous concepts.

Consider presenting the client's oral or written testimony. 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 a taxpayer's testimony if it is unrefuted, credible, probable, believable, and reasonable.²⁴ If the 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 the 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.

If there are new issues that must be raised, do so early in the Appeals process. Appeals Officers are required to consider the merits of new issues raised by a taxpayer.²⁵ 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 of 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 (e.g., other unrelated matters that the client may have with the IRS). There are separate rules for disputing these matters that should be followed.

Have a settlement in mind and if appropriate, offer it at the first Appeals conference.

Appeals Officers appreciate taxpayers and representatives who "get down to brass tacks" rather than spend months wrangling over the issues. But don't offer a nuisance value settlement because an Appeals Officer is required to reject it.²⁶

If the Appeals Officer requests additional documents or information, provide it promptly.

There are two reasons for this. First, by doing so, it demonstrates to the Appeals Officer a desire to resolve the case quickly. The second reason is that it shows cooperation. If there is a lengthy period before the documents and information are provided, this could be viewed as a lack of cooperation and may prevent the client from shifting the burden of proof to the IRS if there is no settlement and the case ends up in litigation.²⁷

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 nondocketed case, Appeals Officers are required to solicit a consent to extend the statute of limitation.²⁸ Under local procedures, this usually occurs five to six months before the statute of limitation is due to expire. A tax practitioner should never try to get the Appeals Officer to concede an issue in exchange for agreeing to sign the consent.

Don't use a "loser" issue as leverage. In most cases, there will be adjustments in the examiner's report that are not in dispute. No attempt should be made to use the client's concession of these undisputed issues as leverage to persuade the Appeals Officer to concede disputed issues. The client will fare better in Appeals if these undisputed issues are conceded either in the protest or at the first Appeals conference.

Conclusion

Understanding the Appeals process, how Appeals Officers reach a settlement, and following a few common-sense rules will enable the tax practitioner to better represent their clients in Appeals, and perhaps will lead to a more favorable settlement for their clients.

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FOOTNOTES

¹ IRS Document 7225, "History of Appeals" (Nov. 1987), p.6

² Policy Statement P-8-1.

³ Treas. reg. section 601.106(b).

⁴ See Rev. Proc. 87-24, 1987-1 C.B. 720.

⁵ Treas. reg. section 601.106(f)(2).

⁶ Treas. reg. section 601.106(f)(1) requires Appeals representatives to handle the case with strict impartiality between the taxpayer and the government, and without favoritism or discrimination of any taxpayer.

⁷ The term "Appeals Officer" used in this article includes Settlement Officers, who are Appeals personnel who specialize in Collection cases.

⁸ 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 section 1001, Internal Revenue Service Restructuring and Reform Act of 1998, Pub. Law. No. 105-206, 112 Stat. 685; Rev. Proc. 2000-43, 2000-43 IRB 404, *Doc 2000-26002 (23 original pages), 2000 TNT 197-5*.

⁹ See Internal Revenue Service Standard Position Descriptions for Appeals Officers.

¹⁰ The Appeals Manual uses the terms "hazards of litigation" and "litigation hazards" in several places, but never defines these terms.

¹¹ Internal Revenue Manual section 8.6.1.3(2).

¹² In relevant part, Treas. reg. section 601.106(f)(2) states, "Appeals will ordinarily give serious consideration to an offer to settle a tax controversy on a basis which fairly reflects the relative merits of the opposing views in light of the hazards which would exist if the case were litigated."

¹³ Internal Revenue Manual sections 8.6.1.3.1 and 8.6.1.3.2.

¹⁴ *Id.*, section 8.6.1.3(1).

¹⁵ *Id.*, section 8.6.1.3.2(1).

¹⁶ *Id.*, section 8.6.1.3.2(3), (4) and (5).

¹⁷ *Id.*, section 8.12.1.2.

¹⁸ *Id.*, section 8.2.1.2.2(2). See also Treas. reg. section 601.106(f)(6).

¹⁹ *Id.*, section 8.2.1.2.2(3).

²⁰ See Burgess J.W. Raby and William L. Raby, "Tax 20 Forum: Quantifying Hazards of Litigation," *Tax Notes*, October 20, 1997, p. 331.

²¹ Internal Revenue Manual section 8.6.1.2.6.

²² *Id.*, section 8.6.1.3.5.

²³ *Id.*, section 8.6.1.3.4.

²⁴ 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 par. 9318, 551 F.2d 929, 931 (3rd Cir. 1977); *Loesch & Green Construction Co. v. Commissioner*, 54-1 USTC par. 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 par. 9273, 456 F.2d 145, 148 (6th Cir. 1972); *Geiger v. Commissioner*, 71-1 USTC par. 9333, 440 F.2d 688 (9th Cir. 1971); *Baird v. Commissioner*, 70-1 USTC par. 9705, 438 F.2d 490, 493 (3rd Cir. 1970).

²⁵ Internal Revenue Manual section 8.6.1.4.4.

²⁶ *Id.*, section 8.6.1.3.3 and Treas. reg. section 601.106(f)(2). These sections also provide that Appeals Officers are not allowed to offer a nuisance value settlement.

²⁷ One of the requirements for shifting the burden of proof to the IRS in a court proceeding is that the taxpayer must have maintained all records required under the code and must have cooperated with the IRS's reasonable requests for witnesses, information, documents, meetings and interviews. See section 7491(a)(2)(B).

²⁸ Internal Revenue Manual section 8.2.1.3.3.

END OF FOOTNOTES

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Tax Analysts Information

Geographic Identifier: United States

Subject Area: Practice and procedure

Author: Fogel, David M.

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Tax Analysts Document Number: Doc 2003-13388 (7 original pages) [[PDF](#)]

Tax Analysts Electronic Citation: 2003 TNT 105-5

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