

# Can You Get the IRS to Pay Part of Your Representation Fees?\*

By  
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David Fogel explains the rules of Code Sec. 7430 and encourages practitioners who represent clients before the IRS in audits and appeals to be aware of these rules so that they can help their clients recover representation fees where appropriate.

Section 7430 of the Internal Revenue Code allows taxpayers to recover administrative and litigation costs from the IRS in certain situations. Of the two dozen or so cases decided by the courts over the past year on this issue, the courts awarded administrative and/or litigation costs in about half of these cases. For those of you who represent clients before the IRS in audits and appeals, you need to be aware of the rules of Code Sec. 7430 because your client just might be able to recover part of your representation fees from the IRS.

1. The determination, collection or refund of any tax, interest or penalty imposed by the Code.
2. For administrative costs, the taxpayer must file a claim within 90 days from the date
3. For litigation costs, the taxpayer must have exhausted the administrative remedies available within the IRS.
4. No costs are allowed for the period during which the taxpayer or representative has unreasonably protracted the proceeding.
5. For administrative costs, the taxpayer must file a claim within 90 days from the date

## Basic Requirements of Code Sec. 7430

There are five basic requirements for the recovery of either administrative or litigation costs from the IRS:

1. The taxpayer must be the “prevailing party.”
2. The administrative or court proceeding must be brought by or against the United States in connection with

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that the IRS mailed its final determination of tax, interest or penalty. For litigation costs, in the absence of an agreement between the parties, the taxpayer must file a motion with the court within 30 days after the court issues its opinion.<sup>1</sup>

### Prevailing Party

To be the “prevailing party,” the taxpayer must have substantially prevailed on either the amount in dispute or on the most significant issue or set of issues presented.<sup>2</sup> In addition, the taxpayer must

its own published guidance.<sup>8</sup> For this purpose, published guidance includes regulations, revenue rulings, revenue procedures, information releases, notices and announcements, but not private letter rulings, technical advice memoranda or determination letters unless issued to the particular taxpayer.<sup>9</sup> If the IRS has lost on substantially similar issues in an appeals court, this will be taken into account in determining whether the IRS’s position was substantially justified.<sup>10</sup>

Sometimes, the IRS changes its position on one or more issues in a case. At what point in time do you look at the IRS’s position to see if it was substantially justified? For an administrative proceeding, you look at the position

taken either in the final decision of IRS Appeals, or the notice of deficiency, whichever is issued first.<sup>11</sup> For a court proceeding, you look at the position taken by the IRS in its answer to the petition filed in Tax Court.<sup>12</sup>

Regardless of whether the IRS establishes that its position was substantially justified, the taxpayer will be treated as the prevailing party if the final adjudicated liability is less than or equal to the liability shown in a qualified offer.<sup>13</sup> A qualified offer is a written offer sent to the IRS offering to settle the case for a specified amount.<sup>14</sup> It may be submitted at any time after the date that the IRS first sends a letter proposing a deficiency (*i.e.*, the 30-day letter) and up until 30 days before the date the taxpayer’s case is set for trial. Making a qualified offer is important because then it will not make any difference whether

the IRS’s position was substantially justified. However, the qualified offer rules will not apply if the case is brought to court and subsequently settled.<sup>15</sup>

### What Types of Proceedings May Result in Recoveries?

Under Code Sec. 7430, fees and costs may be recovered in either an “administrative proceeding” or a “court proceeding.” An administrative proceeding is any proceeding before the IRS, and a court proceeding is any civil action brought in a U.S. court, including the Tax Court.<sup>16</sup>

The IRS has stated in regulations that some types of administrative proceedings do not qualify for recovery of fees and costs under Code Sec. 7430, such as hearings on regulations, comments on forms, requests for private letter rulings, determination letters or technical advice.<sup>17</sup> The IRS has also stated that collection actions are not administrative proceedings,<sup>18</sup> but this is probably an invalid interpretation of the law because the Code specifically states that collection actions are included.<sup>19</sup> This is an important point to consider when more than half of all cases currently handled by IRS Appeals involve collection actions (Collection Due Process cases and Offers in Compromise).

### What Types of Costs May Be Recovered?

The types of costs that are recoverable depend upon whether the costs relate to an administrative proceeding, a court proceeding

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*A taxpayer will not be considered the “prevailing party” if the IRS establishes that its position in the proceeding was “substantially justified.”*

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satisfy a net worth requirement.<sup>3</sup> An individual’s net worth must not exceed \$2 million (\$4 million for a couple filing a joint return). For an entity such as a partnership or corporation, the entity’s net worth must not exceed \$7 million, and the entity must have no more than 500 employees. There are special rules for estates and trusts.<sup>4</sup>

Of course, there are exceptions. (Aren’t there always exceptions?) A taxpayer will not be considered the prevailing party if the IRS establishes that its position in the proceeding was “substantially justified.”<sup>5</sup> The IRS’s position is “substantially justified” if it has a reasonable basis in both fact and law.<sup>6</sup> For a position to be substantially justified, there must be substantial evidence to support it.<sup>7</sup>

There is a presumption that the IRS’s position was not substantially justified if the IRS didn’t follow

or both. Potentially, a taxpayer may recover administrative costs for the administrative proceeding before the IRS and litigation costs for a Tax Court proceeding if the case is litigated in Tax Court and the taxpayer prevails.

For an administrative proceeding, costs include fees not to exceed \$150 per hour charged by a representative authorized to practice before the IRS, administrative fees charged by the IRS, reasonable costs for expert witnesses and reasonable costs for studies or engineering reports necessary to support the taxpayer's case.<sup>20</sup> These are costs that are incurred on or after the earliest of:

- the date that the notice of decision by IRS Appeals is received;
- the date that the notice of deficiency is issued;
- the date that the IRS sends its first letter of proposed deficiency which allows for an administrative review by Appeals (*i.e.*, 30-day letter); or
- the date that the taxpayer makes a qualified offer.<sup>21</sup>

For a court proceeding, costs include reasonable court costs (*e.g.*, the \$60 filing fee imposed by the Tax Court for filing a petition), fees not to exceed \$150 per hour in connection with the court proceeding charged by an attorney, a person who is admitted to practice before the Tax Court or a representative authorized to practice before the IRS, reasonable costs for expert witnesses in connection with the court proceeding and reasonable costs for studies or engineering reports that the court finds necessary for the preparation of the taxpayer's case.<sup>22</sup> The costs of preparing and pursuing the motion for litigation costs also may be included.<sup>23</sup>

## Exhausting Administrative Remedies

As mentioned above, to qualify for recovery of litigation costs, the taxpayer must have exhausted the administrative remedies available within the IRS. A taxpayer has exhausted administrative remedies if the taxpayer or representative, at the earliest available opportunity, requests a conference with IRS Appeals, and if such a conference is granted, he or she participates in that conference.<sup>24</sup>

The regulations state that the taxpayer or representative must request a conference with IRS Appeals before the notice of deficiency is issued, and must participate in that conference before a petition is filed with Tax Court.<sup>25</sup> What happens if the IRS doesn't issue a 30-day letter allowing for an opportunity for a conference with Appeals, but instead, issues a notice of deficiency? In this situation, the taxpayer's first opportunity to participate in a conference with Appeals is after the petition is filed and the case is referred by IRS Counsel to Appeals for settlement.<sup>26</sup> The regulations provide that in such a situation, a taxpayer or representative who participates in an Appeals conference after the petition is filed has exhausted administrative remedies.<sup>27</sup>

## What Is Meant by "Unreasonably Protracted the Proceeding"?

As mentioned above, no costs are allowed for the period during which the taxpayer or representative has "unreasonably protracted

the proceeding." The Code, legislative history and regulations do not define this phrase.<sup>28</sup> However, a few court cases have addressed this point. A taxpayer or representative has unreasonably protracted the proceeding if he or she repeatedly rescheduled appointments, failed to provide information that the IRS requested (or was slow to provide that information), failed to appear for scheduled appointments, made frivolous arguments or otherwise delayed the audit or appeal unnecessarily.<sup>29</sup>

## Filing a Claim for Administrative Costs

To recover administrative costs, a taxpayer must file a written request for such costs with the IRS person who has jurisdiction over the matter.<sup>30</sup> If that person is unknown, then the taxpayer may send the request to the IRS office that considered the underlying matter. The request must include:

- a statement by the taxpayer that the issue of reasonable administrative costs is not, and has never been, before any U.S. court;
- a clear and concise statement of the reasons why it is alleged that the IRS's position in the administrative proceeding was not substantially justified;
- a statement from the taxpayer demonstrating that the taxpayer has substantially prevailed;
- a statement that the taxpayer has not unreasonably protracted the administrative proceeding;
- a statement that sets forth the nature and amount of each item of administrative costs for which the taxpayer is

seeking recovery supported by an affidavit executed by the taxpayer;

- an affidavit executed by the taxpayer stating that the taxpayer meets the net worth requirements; and
- copies of billing records to support representation fees.<sup>31</sup>

The request must be filed with the IRS within 90 days after the date that the final determination is provided to the taxpayer.<sup>32</sup> There is no prescribed form for submitting this information.

A taxpayer may not recover administrative costs under this procedure if a petition was filed with the Tax Court. Rather, the administrative costs must be included in a motion for administrative and litigation costs filed with the Tax Court. For example, if a taxpayer receives a notice of deficiency, files a petition with the Tax Court and prevails, any claim for administrative costs must be pursued in the Tax Court, not the IRS.<sup>33</sup>

## How Does the IRS Decide a Claim for Administrative Costs?

IRS Appeals makes the final decision on a claim for administrative costs in a case that is not litigated in court.<sup>34</sup> It may take some time before the claim is decided by Appeals and an award is granted because (1) such claims are generally low priority cases in Appeals, (2) the cases are infrequent and Appeals Officers are oftentimes unaware of the procedures or the law pertaining to such cases, (3) any settlement in which the taxpayer is granted an award must be approved by the Director of General Appeals (Headquarters)

in Washington, D.C., and (4) the award, if any, must be processed by the Treasury (not the IRS) for payment from its general judgment fund.<sup>35</sup>

A taxpayer who doesn't agree with the IRS Appeals' decision on the claim for administrative costs may file a petition for review with the Tax Court within 90 days from the date of the decision.<sup>36</sup> If the IRS does not respond to the merits of a taxpayer's request for administrative costs within six months from the date it was filed, a taxpayer need not wait for the Appeals decision and may file a petition with the Tax Court.<sup>37</sup>

## Filing a Motion for Litigation Costs

To recover administrative and litigation costs where there is a Tax Court proceeding, a taxpayer must file a motion for such costs with the Tax Court. In the absence of an agreement between the parties, the motion must be filed within 30 days after the court issues its opinion.<sup>38</sup>

The motion must contain:

- a statement that the court proceeding commenced after February 28, 1983;
- if the motion includes a claim for administrative costs, a statement that the administrative proceeding began after November 10, 1988;
- a statement sufficient to demonstrate that the taxpayer is the prevailing party;
- a statement supported by an affidavit from the taxpayer demonstrating that the taxpayer meets the net worth requirements;
- a statement that the taxpayer has exhausted the administrative remedies available within the IRS;

- a statement that the taxpayer has not unreasonably protracted either the administrative proceeding or the court proceeding;
- a statement of the specific litigation and administrative costs for which the taxpayer is seeking recovery supported by an affidavit setting forth the nature and amount of each item;
- if the taxpayer requests a hearing on the motion, a statement explaining why the court can't dispose of the motion without a hearing;
- if a qualified offer was made, a copy of the qualified offer; and
- an appropriate prayer for relief.<sup>39</sup>

The IRS is required to file a response to the motion within 60 days after receiving it, and the parties are required to discuss the motion and agree to as many of the issues raised as possible.<sup>40</sup> Generally, the Tax Court will then rule on the motion by issuing a written opinion.

## Strategies to Maximize Recoveries

### *Send a "Qualified Offer" to the IRS at the Earliest Possible Date*

This generally starts the clock running on costs that may be recovered. The qualified offer does not need to be a "settlement offer." In determining the amount to be offered, you should calculate what you believe will be the final outcome of the case and offer an amount that is slightly more than this outcome.

For example, suppose that the IRS raises two issues and proposes a deficiency of \$5,000. You be-

lieve that the IRS will probably prevail on one of these issues. The other issue is a legal interpretation that you believe Appeals will ultimately concede. You believe that the final outcome after Appeals' concession will be \$1,500. Accordingly, a qualified offer of \$1,600 would be reasonable.

Make the qualified offer in writing and send it to the examiner as soon as possible after the examiner has proposed a deficiency (e.g., 30-day letter). The qualified offer does not have to explain how you arrived at the amount. Merely state in the letter something like, "The taxpayer hereby makes a qualified offer of \$1,600 under Code Sec. 7430 to settle Mr. Smith's income tax liability for the taxable year 2003."

### If Possible, Try to Settle the Costs Issue with the IRS

Not all claims for litigation costs need to be decided by the court. In fact, I am aware of at least two cases brought before the Tax Court where claims for litigation costs were settled with the local IRS Counsel. IRS Area Counsel has the authority to settle claims for administrative costs of \$5,000 or less, and for litigation costs of \$25,000 or less, which means that the IRS headquarters office in Washington, D.C. need not approve claims for less than these amounts.<sup>41</sup>

### Pursue the Claim If the IRS's Position on Even One Issue Was Not Substantially Justified

If the qualified offer procedures don't apply, and if the taxpayer is the prevailing party, costs will be recoverable if the IRS's position was not substantially justified. The analysis of whether the IRS's position was substantially justified is made on an issue-by-issue basis. Accordingly, it is possible to recover costs that are attributable to issues for which the IRS's position was not substantially justified while at the same time not recover costs on issues for which the IRS's position was substantially justified.<sup>42</sup>

For example, in *C.B. Owens*<sup>43</sup> there were two issues before the court: (1) whether the taxpayer was required to include an amount in gross income for discharge of indebtedness; and (2) the 20-percent accuracy penalty. The taxpayer incurred reasonable attorneys' fees of \$8,697.49 in pursuing the case. The Tax Court held that the government's position on the discharge of indebtedness issue was substantially justified, but its position on the penalty was not. The Tax Court ruled that the fees allocable to the penalty issue should be calculated on the basis of the dollar value of each

issue. Since the discharge of indebtedness issue represented 100 percent of the tax, and the penalty issue represented 20 percent of the tax, the amount allocable to the penalty issue was 20 percent divided by 120 percent, or one-sixth. Therefore, the Tax Court awarded one-sixth of \$8,697.49, or \$1,449.58 to the taxpayer under Code Sec. 7430.<sup>44</sup>

## Conclusion

As this article demonstrates, the rules for recovering costs under Code Sec. 7430 can be complicated. However, if the rules are properly followed, a claim for administrative costs, or a motion for litigation costs, can result in an award. If you are a tax preparer, enrolled agent or CPA and you represented a client before the IRS in an audit and/or appeal, and the client subsequently engaged a tax attorney who successfully litigated the case in Tax Court, your client could potentially recover part of your representation fees. Accordingly, being aware of the rules and applying the proper strategies will help you understand the circumstances in which you can get the IRS to pay part of your representation fees.

### ENDNOTES

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<sup>1</sup> Code Sec. 7430(a) and (b); Rule 231(a)(2), Tax Court Rules of Practice and Procedure.

<sup>2</sup> Code Sec. 7430(c)(4)(A)(i).

<sup>3</sup> Code Sec. 7430(c)(4)(A)(ii).

<sup>4</sup> Code Sec. 7430(c)(4)(D)(i).

<sup>5</sup> Code Sec. 7430(c)(4)(B)(i).

<sup>6</sup> *Pierce v. Underwood*, SCt, 487 US 552, 108 SCt 2541, UNEMPLOYMENT INS. REP. ¶14,030A (1988); *C.S. Huffman*, CA-9, 92-2 USTC ¶50,570, 978 F2d 1139, *aff'g. in part and rev'g. in part*, 61 TCM 2289, Dec.

47,266(M), TC Memo. 1991-144; *J.H. Swanson*, 106 TC 76, 86, Dec. 51,155 (1996); *M.L. Powers*, 100 TC 457, 470, 473, Dec. 49,059, *aff'd on this issue, rev'd in part and remanded on other issues*, CA-5, 95-1 USTC ¶50,086, 43 F3d 172.

<sup>7</sup> *Pierce, id.*, at 564–65; *Powers, id.*, at 473.

<sup>8</sup> Code Sec. 7430(c)(4)(B)(ii).

<sup>9</sup> Code Sec. 7430(c)(4)(B)(iv).

<sup>10</sup> Code Sec. 7430(c)(4)(B)(iii).

<sup>11</sup> Code Sec. 7430(c)(7)(B).

<sup>12</sup> Code Sec. 7430(c)(7)(A); *Huffman, supra* note 6, at 1147–48; *Maggie Management Co.*, 108 TC 430, Dec. 52,080 (1997).

<sup>13</sup> Code Sec. 7430(c)(4)(E).

<sup>14</sup> Code Sec. 7430(g).

<sup>15</sup> Code Sec. 7430(c)(4)(E)(1)(ii)(I).

<sup>16</sup> Code Sec. 7430(c)(5) and (6).

<sup>17</sup> Reg. §301.7430-3(a)(1) through (3).

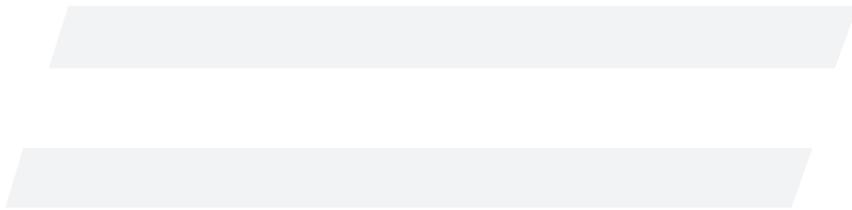
<sup>18</sup> Reg. §301.7430-3(a)(4). See also Reg. §301.7430-3(d), Example 6.

<sup>19</sup> Code Sec. 7430(a) states that costs may be recovered in any administrative proceeding involving "... the determination, collection, or refund of any tax, interest, or penalty ..." [emphasis added].

<sup>20</sup> Code Sec. 7430(c)(2) and (3). See also Rev. Proc. 2003-85, 2003-49 I.R.B. 1184. Representation fees may be recovered even if the taxpayer was not charged any fees for

### ENDNOTES

- representation (*i.e.*, pro bono work). Code Sec. 7430(c)(3)(B).
- <sup>21</sup> Code Sec. 7430(c)(2) and (c)(4)(E)(iii)(II).
- <sup>22</sup> Code Sec. 7430(c)(1) and (3). *See also* Rev. Proc. 2003-85, IRB 2003-49, 1184. As with administrative costs, representation fees may be recovered even if the taxpayer was not charged any fees for representation.
- <sup>23</sup> *Huffman*, *supra* note 6.
- <sup>24</sup> Reg. §301.7430-1(b)(1).
- <sup>25</sup> *Id.*
- <sup>26</sup> *See* Rev. Proc. 87-24, 1987-1 CB 720.
- <sup>27</sup> Reg. §301.7430-1(f)(2).
- <sup>28</sup> Reg. §301.7430-2(d) is entitled “Unreasonable protraction of administrative proceeding” but never defines this phrase.
- <sup>29</sup> *See, e.g., W.C. Gaskins*, 71 TCM 3165, Dec. 51,392(M), TC Memo. 1996-268.
- <sup>30</sup> Reg. §301.7430-2(c)(1) and (2).
- <sup>31</sup> Reg. §301.7430-2(c)(3)(i), (ii) and (iii)
- <sup>32</sup> Reg. §301.7430-2(c)(5).
- <sup>33</sup> Reg. §301.7430-2(b)(1)(i) and 301.7430-2(e), *Example 2*.
- <sup>34</sup> IRM 8.4.1.4.4 (paragraph 3).
- <sup>35</sup> IRM 8.4.1.4.4 (paragraph 7), IRM 8.4.1.4.5 (paragraph 5), and Code Sec. 7430(d)(2).
- <sup>36</sup> Code Sec. 7430(f)(2).
- <sup>37</sup> Reg. §301.7430-2(c)(7) states that IRS’s failure to respond to the claim within six months may be considered by the taxpayer as the IRS’s decision to deny the claim.
- <sup>38</sup> FED. TAX CT. R. PRAC. PROC. 231(a)(2).
- <sup>39</sup> FED. TAX CT. R. PRAC. PROC. 231(b), (d) and (e).
- <sup>40</sup> FED. TAX CT. R. PRAC. PROC. 232(b) and (c).
- <sup>41</sup> CC-2003-013 (Apr. 22, 2003).
- <sup>42</sup> *See* Reg. §301.7430-5(c)(2); *Foothill Ranch Co. Partnership*, 110 TC 94, Dec. 52,555 (1998); *T.J. Mitchell*, 79 TCM 1954, Dec. 53,863(M), TC Memo. 2000-145.
- <sup>43</sup> *C.B. Owens*, 84 TCM 419, Dec. 54,898(M), TC Memo. 2002-253, *aff’d in part, rev’d in part and rem’d*, CA-5, 2003-1 USTC ¶50,518, 67 FedAppx 253.
- <sup>44</sup> The Appeals Court subsequently ruled that the IRS’s position on the discharge of indebtedness issue also wasn’t substantially justified, resulting in a larger award.



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