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TAXPAYER APPEALS PROCEDURES IN THE INTERNAL REVENUE SERVICE

VANCE N. BATES*

BACKGROUND

A taxpayer files his return with the District Director of Internal Revenue for the district in which he has his legal residence or principal place of business. If he has no legal residence or place of business in any internal revenue district, he should file his return with the District Director of Internal Revenue, Baltimore, Maryland. If the taxpayer lived outside of the United States during the tax year and had no legal residence or principal place of business in any internal revenue district in the United States, he should file his return with the Office of International Operations, Internal Revenue Service, Washington 25, D.C. For the purpose of this discussion, it is assumed that the taxpayer has filed a timely return with the District Director for the district in which the taxpayer resides and has his principal place of business.

As soon as practicable after the return is filed, the District Director's office makes a preliminary examination of the return for mathematical errors. If an error is discovered, a correction notice is sent to the taxpayer. He is billed for any additional tax due; if there is an overpayment, the excess is applied to future tax installments, is credited, or is refunded, at the direction of the taxpayer.

Thereafter, the return is reviewed by the Audit Division of the District Director's office and is either accepted as filed or selected for audit. If the return is selected for audit, the taxpayer is notified and the examination will be conducted by a revenue agent from the Audit Division of the district office. The examination may be by office audit, which is generally handled by correspondence; although, if the taxpayer is located near the office where his return is being examined he may be requested to appear at the Internal Revenue office. If the examination is by field audit, a revenue agent will conduct the investigation at the taxpayer's home or place of business.

The procedures described are applicable to the verification of claims for refund filed by the taxpayer, as well as to his return which has been selected for audit. There are special procedures if it is suspected that the taxpayer has filed his return or claim with an intent to defraud the Government. These procedures are extraordinary and will not be discussed here.

There are three levels set up within the Internal Revenue Service for the resolution of disputes as to the amount of a taxpayer's income tax liability. The three levels are available whether the Internal Revenue

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Service is verifying a claim submitted by the taxpayer or whether the Service has started the proceeding by an audit of the taxpayer's return. It is immaterial whether the examination was by office or field audit.

THE REVENUE AGENT'S AUDIT

If the examination of the taxpayer's return has been by office audit, the taxpayer will receive a statement of any adjustments proposed and a computation of the proposed tax liability showing the deficiency or overassessment as the case may be, together with an agreement, Form 870. If the taxpayer agrees with the proposals, he will ordinarily sign the agreement form and return it to the District Director, and the proposed deficiency will be assessed or the overassessment scheduled according to agreement.

If the taxpayer does not agree in due time with the proposals in an office audit report, he will receive a letter from the District Director, enclosing another Form 870 agreement and providing three options:

1. To sign and return the Form 870.
2. To request within 15 days an informal conference with the Conference Coordinator for the District or one of his assistants.
3. To file within 30 days a formal protest with a request for hearing before the Appellate Division.

If the examination of the taxpayer's return has been by field audit, when the agent finishes his examination he will discuss with the taxpayer or his representative any adjustments he proposes to make. It is at this level that the first disputes arise and by far the largest number are disposed of. Many of the agent's proposed adjustments may reflect a lack of facts or a misinterpretation of the facts as he has found them. When the taxpayer or his representative furnishes the agent with all the information he needs the vast majority of disputes will end there; either the agent will be convinced that his proposal was not correct, wholly or in part, or the taxpayer will be persuaded that the agent was correct.

The desirability of full cooperation with the examining officer, whether in an office or field audit, cannot be overemphasized if disputes are to be avoided or resolved satisfactorily and most economically at any level of the procedures.

In the field examination, if the agent does not reach an agreement he prepares and mails to the taxpayer a statement of the proposed adjustments together with an invitation to request an informal conference with the Conference Coordinator for the district or one of his assistants.

THE INFORMAL CONFERENCE

This is the second level of the administrative appeals procedure provided by the Internal Revenue Service. It is a conference with a representative of the District Director. The representative ordinarily will be

the Conference Coordinator or one of his assistants and will not be the supervisor of the group of which the examining agent is a member. The conference will be scheduled at the time and at a place mutually convenient to the taxpayer or his representative and the District representative.

The informal conference is, as the name implies, a completely informal meeting wherein the taxpayer or his representative, or both, may present the reasons for their position on the issue or issues involved. Although not required, it is recommended that the taxpayer's request for an informal conference be in writing, accompanied by a statement of facts and authorities. In complicated cases, the taxpayer is asked to submit a written statement, but he is not compelled to do so. When the facts are disputed, the best available evidence should be submitted to support the taxpayer's view of the facts. If a legal issue is involved, it is best submitted in writing.

The basis for the decision of the conferee for the District Director is the statement of the proposed adjustments and additional facts presented by the taxpayer either in his statement or during the discussion. The decision must take into account the established facts, the law, the regulations, the ruling of the Internal Revenue Service, and court decisions which have been accepted as correct (acquiesced in) by the Commissioner Internal Revenue. The District conferee may not consider the hazards of litigation in a particular issue, nor may he compromise the tax liability by trading issues; his decision must be based on established facts, established law, and the Internal Revenue Service position on any given issue.

At the end of the informal conference, the District conferee may (1) propose to concede some or all of the taxpayer's contentions, (2) insist on some or all of the examiner's contentions, or (3) assert an increased deficiency or reduced overassessment over the amount proposed by the examining officer.

If an agreement is reached at the informal conference, the taxpayer may sign the waiver, Form 870, agreeing to the increase or decrease in his tax liability, or agreeing to a waiver of a disallowance notice if part or all of a refund claim is disallowed. In this event, the conclusions are incorporated in the revenue agent's report on the audit and will become the official determination. The deficiency will be assessed or the overpayment scheduled.

If no agreement is reached at the informal conference, the taxpayer receives a copy of the revenue agent's report, together with a so-called 30-day letter which is the first formal statement by the District Director of an intent to adjust the tax liability. The taxpayer is given 30 days from the date of the letter to decide on one of three courses of action:

1. He may file a formal protest, under the penalties of perjury, to the District Director and request that the case be transferred to the Appellate Division.

2. He may sign the waiver, Form 870, agreeing to the proposed adjustment to the tax.
3. a. If an increase in tax is proposed, the taxpayer can, by written request or by failing to answer within 30 days, secure the issuance of the statutory notice of deficiency, termed a 90-day letter. If taxpayer wishes to appeal his case to The Tax Court of the United States, his appeal (petition) must be filed with the court within 90 days from the date of the letter. In lieu of appealing to the Tax Court, the taxpayer may pay the additional tax asserted in the 90-day letter and file a claim for refund within two years from the time of payment. If the claim is disallowed, suit may be filed in a United States District Court or the United States Court of Claims.

During the 90-day period the taxpayer may, of course, sign the Form 870 agreement in accordance with which the additional tax will be assessed. Or, the taxpayer may take no action at all during the 90-day period, in which case the District Director will assess the tax. As noted above, after the tax is paid, a claim for refund may be filed, and if it is disallowed or no action taken on it within six months, a suit for refund may be filed in a United States District Court or Court of Claims.

It should be emphasized here that the appeal to the Tax Court requires an asserted deficiency in tax and a petition to the Tax Court within 90 days of the issuance of the statutory notice of deficiency. Once the District Director has assessed the tax as the result of the executed waiver, Form 870, payment has been made without execution of the waiver, or the 90-day period has expired, the appeal cannot be made to the Tax Court. The remedy must lie in a claim for refund and a suit for refund in the United States District Court or Court of Claims.

- b. If a claim for refund was the subject for discussion at the informal conference, the taxpayer is given a disallowance notice, either at his request that the notice be issued or by failing to answer the 30-day letter. After he receives the notice of disallowance, the taxpayer may file suit for refund in a United States District Court or Court of Claims. The suit must be filed within two years of the date of mailing, by certified or registered mail, the notice of disallowance. If the taxpayer has signed a waiver of the notice of disallowance, the suit must be brought within two years from the date the waiver was signed.

THE APPELLATE DIVISION

The Appellate Division is the third and top level of the administrative appeals procedure provided by the Internal Revenue Service. The division is not attached to any district, but is attached to the office of the Regional Commissioner of Internal Revenue. Chiefs of the Appellate Division,

Associate Chiefs, and within certain defined limits the Assistant Chiefs and Special Assistants are vested with the exclusive and final authority to represent the Commissioner of Internal Revenue in the determination of protested income, profits, estate, and gift tax liabilities, both before and after the issuance of the statutory notice of deficiency, and in the determination of certain excise and employment tax liabilities, in all cases originating in the offices of the District Directors within their regions. In the simplest terms, the Appellate Division settles disputes between District Directors and taxpayers.

While there is no formal procedure for hearings before the Appellate Division and professional representation of taxpayers is not required, in the great majority of cases considered by the division there is a lawyer or accountant, or both representing the taxpayer. In view of the genuine controversies and complicated issues usually involved in cases considered by the Appellate Division, the taxpayer usually finds it to his advantage to have skilled representation. The Appellate Division will not consider any case unless a protest has been filed with the District Director or a statutory notice of deficiency (the 90-day letter) has been issued. The negotiations are more formal and in most cases involve questions of tax law, rather than questions of fact. A settlement reached with the Appellate Division is generally intended to reflect a binding agreement by both parties.

Cases considered by the Appellate Division on the basis of a protest to the District Director and a request for a hearing before the Appellate Division are termed pre-90 day cases (cases considered before a statutory notice of deficiency is issued). The protest should be certified by the taxpayer as true under penalties of perjury. It should contain: the name and address of the taxpayer; a designation by date and symbols of the document advising the taxpayer of the adjustments that are protested; the year or years covered; an itemized schedule of the findings the taxpayer disagrees with; a statement of the facts the taxpayer relies on for each issue he wants to contest; if the protest is prepared by the taxpayer's attorney or agent, a signed statement by the attorney or agent that he prepared the protest and indicating whether or not he knows of his own knowledge that the facts stated are true.

When the Appellate Division receives any case, it proceeds immediately to offer an early conference for the purpose of disposing of the issues on a mutually satisfactory basis. The place of the conference is generally the Appellate office serving the district in which the case originated. In a limited number of cases, to serve the convenience of the taxpayer, the conference may be held at a location closer to the taxpayer's address than is the Appellate office. The case is assigned to a technical advisor in the Appellate Division who will study the case, arrange and hold the conferences on it, and prepare the necessary report to his supervisor, an Associate

Chief, Assistant Chief, or Special Assistant, who must approve or disapprove the technical advisor's recommendation for disposition of the case.

If the negotiations for settlement of a pre-90-day case result in an agreement and there are mutual concessions by the taxpayer and the Internal Revenue Service, or by the Service only, an agreement will usually be signed by the taxpayer or on his behalf by his representative and by the Appellate supervisor on behalf of the Commissioner of Internal Revenue. This agreement is considered binding on both parties and as accomplishing a final disposition in the absence of fraud, malfeasance, concealment or misrepresentation of material fact, or an important mistake in mathematical calculations.

Where the Internal Revenue Service has made no concessions in the proposed settlement of the case, the taxpayer or his representative will usually execute an agreement providing for prompt assessment of the deficiency or scheduling of an overassessment.

In deficiency cases where the taxpayer and the Appellate Division do not reach an agreement, if the taxpayer intends to present his case to the Federal District Court or Court of Claims, he may sign the agreement which permits immediate assessment and collection, pay the tax, file a claim for refund, and bring suit, as described previously. If the case involved a claim for refund, the taxpayer will receive an official notice of disallowance unless he has waived notice and he may then file suit.

If a deficiency is involved in an unagreed case and the taxpayer intends to present his case to the Tax Court or is undecided as to which court he wants to hear his case, the Appellate Division will issue the statutory notice of deficiency. As described, the petition to the Tax Court must be filed within 90 days. If the petition is not filed, the deficiency will be assessed. After paying the assessed tax, the claim for refund procedure will again be applicable, and after the claim is officially disallowed a suit for recovery may be filed in the proper Federal District Court or Court of Claims.

The Appellate Division also functions on all cases docketed for hearing by the Tax Court after the issuance by a District Director of a statutory notice of deficiency and the filing of a timely petition to the Court. The taxpayers petition is answered by Regional Counsel's office, and that office then refers the case to the appropriate Appellate Division office to investigate the settlement possibilities. After the case is docketed, its settlement requires concurrence by both the Appellate Division and Regional Counsel's office until the case is actually called for trial at which point Regional Counsel's office takes full jurisdiction.

When the Appellate Division receives a case in which the statutory notice was issued by a District Director, the petitioner or his authorized representative is contacted with an invitation for a conference to discuss

settlement possibilities. If an agreement is reached as the result of the conference, a stipulation embodying the agreement is signed by or on behalf of the taxpayer and on behalf of the Chief Counsel of the Internal Revenue Service and is filed with the Tax Court which enters its decision on the basis of the stipulation. The resulting tax deficiency or overpayment is assessed and collected or scheduled and refunded.

If an agreement is not reached, the technical advisor in the Appellate Division prepares a report to Regional Counsel recommending that the position of the Service be defended before the Tax Court.

CONCLUSION

The Internal Revenue Service recognizes its responsibility to maintain a fair and even-handed system for granting administrative relief in cases where the taxpayer does not agree with the examining officer's determination. The appeals procedures are designed to assure a prompt hearing, a prompt decision by the Service, and a high quality decision that is fair to both the taxpayer and the Government. The taxpayer and his representative are entitled to know, with the least amount of delay, the final decision of the Service as to the amount of tax liability in the case; at the same time, there must be adequate safeguards to prevent arbitrary actions. The three levels of appeals are intended to meet these objectives. At the first level the taxpayer and his representative will find the revenue agent willing and anxious to discuss the merits of the adjustments he proposes to make. At the second level the Informal Conference sections in the district offices of the Service have been strengthened. A taxpayer or tax practitioner can be assured that he can receive a conference before a district conferee who is not the supervisor of the agent who proposed the adjustment. Where the issue in controversy turns on the facts or an interpretation of the facts, as 90 percent of them do, a reasonable approach to the problem should result in a disposition of the case at the district level, and the great majority of cases will be disposed of there. In those cases where the issue cannot be disposed of except by compromise which takes into account the litigating prospects of the case, the third level of appeal, the Regional Appellate Division, is available. Except in most unusual cases, which can only prove the rule, a reasonable approach by a taxpayer or his representative to any tax problem in which the opinions of honest men may differ should, under the Internal Revenue Service procedures, dispose of the case without resort to litigation.