Defending Liberty
Pursuing Justice

Section of Taxation

Suite 400
1050 Connecticut Avenue, NW
Washington, DC 20036
202-662-8670
FAX: 202-662-8682
E-mail: tax@americanbar.org

TAXATION
A Section of the American Bar Association

May 9, 2017

The Honorable John A. Koskinen
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20024

Re: Comments on Recent Practice Changes at Appeals

Dear Commissioner Koskinen:

Enclosed please find comments on recent practice changes at the Internal Revenue Service Appeals Division ("Comments"). These Comments are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

The Section of Taxation would be pleased to discuss the Comments with you or your staff if that would be helpful.

Sincerely,

William H. Caudill
Chair, Section of Taxation

Enclosure

cc: William M. Paul, Acting Chief Counsel and Deputy Chief Counsel (Technical), Internal Revenue Service
Donna C. Hansberry, Chief (Appeals), Internal Revenue Service
Nikole C. Flax, Deputy Chief (Appeals), Internal Revenue Service
Kirsten B. Wielobob, Deputy Commissioner (Services & Enforcement), Internal Revenue Service
Thomas West, Acting Assistant Secretary (Tax Policy) and Tax Legislative Counsel, Department of the Treasury

AMERICAN BAR ASSOCIATION
SECTION OF TAXATION

Comments on Recent Practice Changes at IRS Appeals

The following comments ("Comments") are submitted on behalf of the American Bar Association Section of Taxation ("Section") and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

These Comments address recent practice changes at Internal Revenue Service ("IRS" or the "Service") Appeals. Principal responsibility for preparing these Comments was exercised by Tom Greenaway of the Committee on Administrative Practice of the Section of Taxation. Substantive contributions were made by the following members of the Committee on Administrative Practice and the Pro Bono and Tax Clinics Committee: Jennifer Breen, Jeremiah Coder, Matthew Cooper, Carol Luttati, Ellen McElroy, T. Keith Fogg, Diane Ryan, Mary Slonina, and Susan Seabrook. The Comments were reviewed by George A. Hani, Committee Chair for the Committee on Administrative Practice and Christine Speidel, Committee Chair for the Pro Bono and Tax Clinics Committee. The Comments were further reviewed by Michael J. Desmond of the Section's Committee on Government Submissions, Sheri Dillon, Council Director for the Committee on Administrative Practice, and Julian Y. Kim, Vice Chair (Government Relations).

Although the members of the Section who participated in preparing these Comments have clients who might be affected by the issues addressed by these Comments, no such member or the firm or organization to which such member belongs has been engaged by a client to make a government submission with respect to, or otherwise influence the development or outcome of, the specific subject matter of these Comments.

Contacts: Tom Greenaway
(617) 988-1221
tgreenaway@kpmg.com

George A. Hani
(202) 626-5953
ghani@milchev.com

Date: May 9, 2017

Executive Summary

At several recent public meetings, the Service Appeals Division ("Appeals") executives solicited comments on recent changes to Appeals practice. We welcome the opportunity to provide our Comments. Many of the recent changes may be driven by the fact that Appeals officials have to do "less with less" during these times of tight budgets and are being implemented from an operational perspective of Appeals management. Nevertheless, we respectfully suggest that several of the changes discussed below blur the lines between Appeals and other elements of the Service so as to jeopardize core values of Appeals. These values provide the foundation of Appeals' well-deserved and long-standing reputation for resolution of controversies in a fair and impartial manner and in such ways that enhance voluntary compliance and public confidence in the integrity and efficiency of the Service.

Our Comments proceed as follows: after a history and background section, we discuss six recent changes made to Appeals practice and provide comments and recommendations regarding each of these changes. In summary:

- First, we recommend that Appeals reinstate the long-standing Internal Revenue Manual ("Manual") provision regarding limited circumstances for attendance by representatives of the Service's Examination divisions ("Compliance") and the IRS Office of Chief Counsel ("Counsel") at settlement conferences.
- Second, we recommend that Appeals return the option for face-to-face settlement conferences to taxpayers.
- Third, we recommend that Appeals publicly reaffirm that independent Appeals Technical Employees may, in all cases, evaluate the hazards of litigation on positions taken by Counsel.
- Fourth, we offer some observations and suggestions regarding informal issue coordination in Appeals.
- Fifth, we support the recent reaffirmation of Appeals Team Case Leader ("ATCL") unilateral settlement authority.
- Finally, we reiterate our recent comments with respect to docketed cases in Appeals' jurisdiction.

If you would find it helpful, we would welcome the opportunity to meet with the appropriate personnel from Appeals to discuss these Comments.

History & Background

For more than 200 years, the Treasury Department has maintained a policy preference to settle tax disputes administratively rather than at trial.[1] For the last ninety years, Appeals and its predecessors have carried the primary responsibility for furthering this policy. The

[1] IRS, HISTORY OF APPEALS 7, Tax Analysts Doc. No. 88-3957 (1987); *see* Policy Statement 4-40, at I.R.M. 1.2.13.1.16.

longstanding mission of Appeals is to resolve tax controversies, without litigation, on a basis which is fair and impartial to both the government and the taxpayer and in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the Service.[2]

Taxpayers, their representatives, and organizations including ours understand the vital role that Appeals plays in our federal tax system. Like Treasury, most taxpayers prefer to settle their tax disputes administratively rather than litigate them. Administrative settlements offer certainty, flexibility, and generally take less time and expense than litigation. Furthermore, Appeals provides taxpayers a meaningful opportunity to be heard on the merits. In other words, Appeals helps the Service meet the constitutional due process obligations the government owes to taxpayers. Not coincidentally, Appeals also serves as a critical safety valve on Service enforcement initiatives.

As the primary administrative dispute resolution forum within the Service, Appeals is uniquely positioned to evaluate evidence, consider the applicable hazards of litigation, and settle taxpayer disputes without litigation—all in a fair and impartial manner that enhances voluntary compliance and public confidence. Fostering agreement at the earliest opportunity provides good taxpayer service, promotes administrative fairness, and conserves Service resources. Conversely, frustrating the effective use of Appeals risks more cases ending up in litigation and weakens the many procedural safeguards afforded taxpayers.

The Service has recognized the institutional need for an independent administrative appeals forum in most circumstances by including the right to appeal a Service determination in the Taxpayer Bill of Rights.[3] The right to independent administrative review is guaranteed by statute in some collection contexts, such as in lien and levy cases[4] and upon the rejection of a proposed offer-in-compromise or the modification or termination of an installment agreement.[5] The Code[6] does not, however, provide taxpayers with a general right to an administrative appeal,[7] and the Tax Court has held that the Service's administrative appeals procedures do not establish substantive rights.[8] The Section has recommended that Congress consider amending section 7123 to provide taxpayers a statutory right to review of all audit determinations in Appeals.[9]

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[2] I.R.M. 8.1.1.1.

[3] *See Taxpayer Bill of Rights: #5 The Right to Appeal an IRS Decision in an Independent Forum*, FS-2016-13 (Mar. 2016).

[4] I.R.C. §§ 6320(b), 6330(b).

[5] I.R.C. § 7122(e); *see* I.R.C. § 6159(e).

[6] All references to "I.R.C.," "section," "§", or "Code" refer to the Internal Revenue Code of 1986, as amended, unless otherwise noted.

[7] *Cf.* I.R.C. § 7123 (directing the Secretary to establish Appeals early referral, mediation, and arbitration procedures).

[8] *See, e.g. Estate of Weiss v. Commissioner*, 90 T.C.M. (CCH) 566, 2005 T.C.M. (RIA) ¶ 2005-284.

[9] ABA Tax Sec., *Comments On Staff Discussion Draft To Reform The Administration Of The Tax Laws* (2014); *see also* Republican Members of H. Comm. on Ways & Means, *A Better Way, Our Vision of a Confident America—Tax* 29 (June 24, 2016) (proposing an independent "small claims unit" within the Service to resolve tax disputes), *available at* http://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf.

The Internal Revenue Service Restructuring and Reform Act of 1998 ("RRA 98") directed the Service to develop and implement a reorganization plan.[10] The plan, among other things, was required to:

> Ensure an independent appeals function within the Internal Revenue Service, including the prohibition in the plan of ex parte communications between appeals officers and other Internal Revenue Service employees to the extent that such communications appear to compromise the independence of appeals officers.[11]

RRA 98 also mandated that the Service ensure that an Appeals Officer is regularly available within each state.[12]

Administrative appeal rights are more than a mere expectation of taxpayers, as shown by the extraordinary public reaction over a decade ago to the denial of appeals rights to certain tax shelter investors.[13] At the time, the Commissioner promised: "The approach that we followed here should in no way be viewed as having set a precedent for subsequent resolution strategies."[14] In response, Senator Grassley, then Chairman of the Senate Finance Committee said: "the Commissioner and I discussed the limitation of appeals rights in this crackdown, and I'm satisfied that he recognizes my view that this should happen only in rare situations."[15] House Ways & Means Oversight Subcommittee chair Representative Amo Houghton said:

> Even with the tremendous outrage by Congress with the Son of Boss structure and the IRS Counsel view that the issue held no litigating hazards for the Government, both Congress and IRS Executives stepped-up to assure the taxpaying public that appeal rights would not be abridged in the future.[16]

Despite the benefits, assurances, and safeguards provided by Appeals, taxpayers are not required to exhaust their administrative appeal rights in order to proceed with litigation of a tax dispute.[17] The Service and others have long recognized that in order to further Treasury's policy goal in favor of administrative settlements, taxpayers must volunteer to work with the Service. Accordingly, the Service's administrative resolution process "must command the respect and trust of taxpayers, and provide them with a prompt and independent review of protested adjustments."[18] To be effective, Appeals not only must

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[10] Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685.
[11] Pub. L. No. 105-206 § 1001(a)(4).
[12] Pub. L. No. 105-206 § 2465(b).
[13] *See* Announcement 2004-46, 2004-21 I.R.B. 964.
[14] IRS Release, *Son of Boss Settlement Initiative* (May 5, 2004), *available at* http://www.irs.gov/uac/son-of-boss-settlement-initiative.
[15] Congressional Statements on the IRS Son-of-Boss Global Resolution Initiative (May 5, 2004), *available at* http://www.irs.gov/uac/Congressional-Statements-on-the-IRS-Son-of-Boss-Global -Resolution-Initiative.
[16] *Id*.
[17] History of Appeals, *supra* note 1 at iii ("When an attempt is made to devise an administrative Government procedure, officials come face-to-face with the very practical fact that citizens will not accept it should they perceive it as unreasonable, unfair or arbitrary. In that event, they would rather litigate their disputes every time.") (remarks of Arthur H. Klotz, Former Director, Appellate Division 1963-1972).
[18] *Id*. at 7.

be fair, but must appear to be fair and free from conflicts of interest.[19] Independence has always been a primary concern for Appeals:

> To be fair and impartial in both fact and appearance, the appeals machinery must be able to operate with a great deal of independence and discretion in order to exercise for the Commissioner of Internal Revenue all of the authority which he has under the law. It cannot be viewed as an adversary and to be successful must not be considered as an extension of either the examination or the litigation functions.[20]

These principles are incorporated in published guidance. Regulation section 601.106 provides the procedural rules and standards that govern Appeals practice.[21] Revenue Procedure 2016-33 provides the current practices for the administrative appeals process for cases docketed in Tax Court.[22] Revenue Procedure 2012-18 provides the current guidance on *ex parte* communications between Appeals and other Service employees.[23]

Delegation Order 8-8 provides the authority for Appeals Team Managers and Appeals Team Case Leaders, among others, to determine the tax and penalty liabilities for taxpayers where the taxpayer protests an original determination by Compliance.[24] The delegation order provides that if the Appeals-proposed disposition is contrary to a Counsel ruling or technical advice with respect to exempt status, foundation classification, or qualification, Counsel will make the final determination. The delegation order does not provide a similar organizational tiebreaker rule for other types of National Office rulings.

Recent Changes in Appeals Procedures

We have observed several important changes to Appeals procedures over the past year. In this comment letter, we focus on the following changes: (a) Compliance and Counsel participation in settlement conferences; (b) conference practices; (c) taxpayer-adverse guidance and rulings; (d) informal issue coordination in Appeals; (e) Appeals Team Case Leader settlement authority; and (f) Appeals jurisdiction in docketed cases. We discuss each topic in turn below.

[19] *Id.*
[20] *Id.* at iii.
[21] In 1993, the Service and Treasury proposed to amend these Regulations, Prop. Reg. § 601.106, 58 Fed. Reg. 48802 (1993), but these Proposed Regulations have not been finalized or withdrawn.
[22] Rev. Proc. 2016-33, 2016-1 C.B. 1034.
[23] Rev. Proc. 2012-18, 2012-1 C.B. 455.
[24] I.R.M. 1.2.47.9.

1. Compliance and Counsel Participation in Nondocketed Settlement Conferences

In nondocketed traditional Appeals cases, Compliance employees and Counsel participate in the preconference (if any), but not in the settlement conference.[25] At the settlement conference, the taxpayer and its representative present to Appeals Officers without Compliance in the room. Participation of Counsel in nondocketed Appeals settlement conferences is—and always has been—rare.

Since at least 1986, the Internal Revenue Manual reflected this tradition: "If advisable, Appeals may request representatives of the Compliance Area Director, engineering, or other experts to attend conferences. Generally, Area Counsel is not involved in Appeals conferences but may be present in cases where criminal prosecution has been recommended and the fraud penalty is contested."[26] This separation between Appeals and other elements of the Service, in a very practical way, helps to establish and maintain the independence and impartiality of Appeals.

As of October 1, 2016, section 8.6.1.4.4 of the Manual, *Participation in Conferences by IRS Employees*, was revised to provide:

> 1. Appeals has the discretion to invite Counsel and/or Compliance to the conference. The prohibition against ex parte communications must not be violated. See Rev. Proc. 2012-18. Appeals may also request that other experts attend conferences.
>
> 2. See other IRM Part 8 sections for participation by IRS employees in cases under the Alternative Dispute Resolution (ADR) Program. This includes IRM 8.26.5.4.7, Participants, that reflects Appeals' discretion to have Counsel, the originating function, or both participate in a Post-Appeals Mediation proceeding for a Non-Collection Case.

To the extent the decision to include Compliance is left to the discretion of the Appeals official with settlement authority over the case, these changes would be consistent with Regulation section 601.106(c), which provides: "At any conference granted by Appeals on a nondocketed case, the district director will be represented if the Appeals official having settlement authority and the district director deem it advisable." However, any mandatory, or Appeals-wide initiative to include Compliance or Counsel in traditional Appeals settlement conferences would be inconsistent with this Regulation because such an initiative would eliminate the discretion the Regulations vest in the Appeals official with settlement authority over the case. Moreover, extending to Counsel the same conference attendance rights as Compliance would disregard the distinction the same Regulation makes between the two functions. The Manual change with respect to Counsel participation in the settlement conference is also inconsistent with Proposed

[25] *See* Reg. § 601.106(c). The most notable exception to this general rule occurs when the Appeals official with jurisdiction over the case considers a particular Compliance subject matter expert's participation important to better understand a complicated situation or issue.

[26] I.R.M. 8.6.1.4.4 (June 25, 2015 rev.); *see* I.R.M. 8.6.1.3.4 (Nov. 6, 2007 rev.); I.R.M. 8.6.1.3.4 (Feb. 1, 2003 rev.); I.R.M. 862.5 (Apr. 21, 1986 rev.). In 2015, the Manual was revised to allow for Counsel Participation in elective Alternative Dispute Resolutions programs such as Fast-Track and Post-Appeals Mediation.

Regulation section 601.106(c)(6)(ii), which mirrors the traditional general prohibition on Counsel attendance at settlement conferences.

We are concerned that Appeals independence is impaired by permitting, encouraging, or mandating that all three parties (Appeals employees, the taxpayer, and Compliance/Counsel personnel) attend all conferences with Appeals. Moreover, such a significant change in conference procedures could interfere with the ability of Appeals to conduct its traditional role of settling the case based on hazards of litigation. Fast Track Settlement and Rapid Appeals Process are existing options if the taxpayer wants to mediate its dispute with Compliance. Taxpayers who choose traditional Appeals have chosen not to mediate, based at least in part on an assessment that the inclusion of Compliance could be counterproductive.

We recommend that Appeals return to the historical process. That is, Appeals may invite Compliance and Counsel to a preconference (if needed), and then the taxpayer should present to Appeals alone, without Compliance and Counsel present. In our view, the settlement discussion (and thus the settlement conference) begins as soon as the taxpayer begins its presentation to Appeals. We recommend that the Manual be updated to provide that while others may attend the preconference (or any other initial conferences necessary to establish the factual and legal background), once the settlement conference begins, the taxpayer is entitled to meet with Appeals alone. There should be a clean break between Compliance and Appeals.

Similarly, we understand that some Appeals Team Case Leaders ("ATCLs") in traditional Appeals cases are currently "strongly encouraging" Compliance and the taxpayer to conduct settlement negotiations similar to Rapid Appeals Process or Fast Track Settlement. Practically, many taxpayers do not feel they can decline such overtures. Any use of Rapid Appeals Process or Fast Track Settlement should be a voluntary decision of both the taxpayer and Compliance teams. Indeed, the care that the revenue procedures take to explain the role of Compliance in Rapid Appeals Process and Fast Track Settlement shows that Compliance and Counsel participation in Appeals cases is—and should be—the exception rather than the rule.

2. Conference Practices – The Face-to-Face Conference

The past several decades have seen a marked centralization of the Appeals function in campus operations. Over time the number of Appeals Officers located in field offices has dwindled. As a result, Appeals often conducts conferences by telephone or correspondence. Many taxpayers find telephone or correspondence conferences to be a quick and efficient means to resolve their issues. However, telephone calls or correspondence do not suit all cases. Traditionally, if the taxpayer or the taxpayer's representative requested a face-to-face conference, Appeals would transfer the case to the appropriate field office to schedule and conduct a face-to-face conference, subject to limited exceptions.[27]

[27] *See* I.R.M. 8.1.1.1.3. This rule was subject to very limited exceptions, such as collection due process cases involving potentially dangerous taxpayers, taxpayers making frivolous arguments, and taxpayers claiming collection alternatives for which they were ineligible. *See also* Reg. § 301.6330-1(d)(2) (Q&A: D-6 through D-8) (providing face-to-face conference rights in collection due process hearings).

In October 2016, the choice of whether to opt for a face-to-face conference (as opposed to proceeding telephonically or by correspondence) was transferred from taxpayers to Appeals. As it presently stands, while the request for an in-person conference may initially be made by the taxpayer, or suggested by the Appeals Officer or Settlement Officer, the Appeals Team Manager must now concur with the decision. In deciding whether to grant an in-person conference, Appeals managers must consider the following criteria:

- Are there substantial books and records to review that cannot be easily referenced with page numbers or indices?
- Can the Appeals Technical Employee judge the credibility of the taxpayer's oral testimony without an in-person conference?
- Does the taxpayer have special needs (*e.g.*, disability, hearing impairment) that can only be accommodated with an in-person conference?
- Are there numerous conference participants (*e.g.*, witnesses) that create a risk of an unauthorized disclosure or breach of confidentiality?
- Will an alternative conference procedure (*e.g.*, Post Appeals Mediation or Rapid Appeals Process) involving separate caucuses be used?
- Does another Manual section specific to the workstream call for an in-person conference?[28]

We respectfully suggest that Appeals should reinstate the availability of a face-to-face conference as the default rule. We firmly believe that face-to-face conference rights have always been one of the most important elements of Appeals practice, and one of the key reasons for Appeals' well-deserved reputation for fairness. Where a face-to-face conference is the default rule, taxpayers may still choose to have a telephone conference. Further, we believe Appeals can continue to identify criteria to withdraw the availability of a face-to-face conference in specified circumstances in which the taxpayer uses the right to a face-to-face conference to delay or frustrate the Appeals proceeding. For example, Appeals Officers and their Team Manager may consider the following circumstances in determining whether to withdraw the availability of a face-to-face conference:

- Has the taxpayer engaged in behavior that has led to extensive delays in scheduling?
- Has the taxpayer repeatedly failed to attend scheduled conferences?
- Is the taxpayer unwilling to travel to attend an in-person conference if required?

In a world of increasingly centralized data processing, personal interaction—the human element of tax administration—is disappearing. More than 50 years ago, the

[28] I.R.M. 8.6.1.4.1.

Commissioner recognized that "[r]egardless of the miracles of automation, our type of tax system cannot operate effectively without the human element. Courtesy and a fair and reasonable attitude—on the part of both tax administrator and taxpayer—are other essential ingredients if this system is to continue to serve the Nation well."[29] Congress more recently confirmed that sentiment by directing in RRA 98 that an Appeals Officer be regularly available within each state. The recent changes to conference practices are at odds with Appeals' long tradition and do not honor the spirit of this Congressional mandate.

For example, in recent years, Appeals has piloted virtual service delivery ("VSD"), which allows "virtual face-to-face" conferences to be held by videoconference.[30] VSD is a positive development and has been beneficial for some taxpayers, but it is not an adequate substitute for being in the room with the decision-maker. An in-person conference has a different human dynamic and better facilitates the understanding and negotiation of complicated and important issues.

In our tax system, billions of dollars of tax deficiencies are proposed, assessed, and collected every year without any human element. The automated data processing systems that make up the bulk of the Service's enforcement efforts are built on structural rules that classify all taxpayers and their returns as either compliant or noncompliant.[31] Experience and analysis show that these systems classify many materially compliant taxpayers as noncompliant.[32] And the systems are designed so that taxpayers caught up in the Service's automated systems are presumed to be noncompliant unless and until they become responsive.[33] When taxpayers do respond, Appeals should be available to meet with them to frankly discuss and resolve their matters.

This need for in-person conferences was recognized by the Service and Treasury with regard to Collection Due Process hearings; Regulation section 301.6330-1(d)(2)(Q&A: D-7) explicitly instructs Appeals to offer a face-to-face hearing in most instances when requested by the taxpayer. Limiting the in-person opportunity set out in the Regulations through informal internal instructions not only diminishes due process rights but does so in a manner that contravenes formal policy decisions made by the Service and Treasury.

In many cases, it is hard enough for taxpayers to explain their often complicated situations to the government—forcing them to write to or call some faraway campus only compounds the difficulty. The Service, as a whole, and Appeals, in particular, need to balance technological capabilities against the actual costs to the nation's taxpayers and the tax system.[34]

Historically, Appeals has been able to resolve, on an agreed-upon basis, a large percentage of the cases it hears. Its ability to independently resolve cases on the basis of

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[29] Mortimer Caplin, IRS Commissioner, "A Personal Letter to Taxpayers" (1962), *available at* https://www.irs.gov/pub/irs-prior/i1040--1962.pdf.
[30] I.R.M. 8.6.1.4.5.
[31] Bryan T. Camp, *Theory & Practice in Tax Administration*, 29 VA. TAX REV. 227, 271 (2009).
[32] *Id.*
[33] *Id.*
[34] Mortimer M. Caplin, *Commissioner Caplin Reviews His Record as IRS Chief,* FED. TAXES REP. BULL., VOL. XLV (July 16, 1964).

hazards of litigation functions to limit the number of matters that would otherwise proceed to Tax Court. The tax system benefits when cases susceptible of resolution are settled sooner rather than later. In order for taxpayers to be amenable to the administrative Appeals process, they must feel that their legal arguments and perspective on an issue have been heard—and for that, there is no substitute for a face-to-face conference. While the submission of briefs or memoranda of law with accompanying supporting documents are important and helpful in articulating the taxpayer's position, a face-to-face conference gives the taxpayer the best opportunity to respond to the specific questions and concerns raised by Appeals that form the basis upon which their matter will ultimately be decided. The fluidity of this dialogue with the exchange of point and counter-point frequently serves to highlight for all parties the relative strengths and weaknesses of their respective positions. The face-to-face conference affords Appeals the best opportunity to analyze the hazards of litigation when the taxpayer's credibility is a key issue—as it almost always is. Absent this kind of oral advocacy, which forces both sides to assess and acknowledge the probability of prevailing (or not) on an issue, we submit that the unique role that Appeals performs in resolving tax disputes will be adversely impacted. Further, in many instances, the process of engaging in a face-to-face conference positions the parties to arrive at a more correct answer with respect to the taxpayer's liability.

In addition, elimination of taxpayer-choice face-to-face conferences may have broader implications for the voluntary compliance system. As noted above, it is important for taxpayers to feel that their legal arguments and perspective on an issue have been heard. The perceived opportunity, or lack thereof, to be heard can have a powerful impact on a taxpayer's view of the fairness and integrity of the voluntary compliance system.

Some government officials have suggested that budget problems forced the elimination of taxpayer-choice face-to-face conferences. We suggest that some of the undeniable savings yielded by the increasing use of automated data processing enforcement programs be redeployed to Appeals—to better deal with taxpayer responses to the millions of computer-generated notices that are issued each year. Of course, Appeals has centralized many of its employees in a handful of campuses around the country and allowed many of its employees to work remotely. We understand the business rationales for these trends. We simply disagree that these trends should limit the availability of Appeals employees in each state—as does Congress.[35]

If Appeals maintains its new policy on face-to-face conferences, we recommend that the factors set out in section 8.6.1.4.1 of the Manual be revised.[36] For example, we respectfully suggest that the voluminous records requirement arguably penalizes well-organized taxpayers. Good tax practitioners—including Appeals Officers—know that credibility of the evidence (both the taxpayer's evidence and the Service's evidence) is almost always an issue in tax disputes. Taxpayers will be put in a Catch-22 if Appeals refuses to meet with them—and then sustains a proposed deficiency or collection action because the faraway taxpayer did not adequately establish his or her credibility. Moreover, it is hard to imagine a special needs situation where face-to-face is easier for

[35] *See* Pub. L. No. 105-206 § 2465(b).
[36] I.R.M. 8.6.1.4.1.

the person with special needs, but the decision should still rest with the taxpayer. While we reiterate our request that the face-to face conference be held based upon taxpayer choice and not upon satisfaction of a list of criteria, if Appeals preserves its new policy, we welcome the opportunity to work with Appeals to establish more appropriate replacement criteria and suggest the following:

- Does the taxpayer want a face-to-face conference?
- What is the taxpayer's rationale for seeking a face-to-face conference?
- Does the taxpayer have a history of cooperation during the examination process?
- Is the taxpayer willing to travel, if necessary?
- Has the taxpayer been cooperative in scheduling the conference so that the conference can be held in a reasonable time frame?
- Are the number and the complexity of issues involved such that a face-to-face conference would assist in the discussion and resolution of the issues?
- What is the amount at issue in relation to the amount shown on the return?
- Are there penalties at issue?

3. Taxpayer-Adverse Guidance in Appeals

a. <u>The long-standing balance between Appeals independence and Counsel's advice</u>

Revenue Procedure 2012-18 summarizes the delicate balancing act the Service tries to maintain between Appeals independence and the role of Counsel's legal advice in Appeals:

> Appeals employees are entitled to obtain legal advice from attorneys in the Office of Chief Counsel and, except as provided below, are permitted to do so under the ex parte communication rules. Appeals employees generally are not bound by the legal advice that they receive from the Office of Chief Counsel. The legal advice is but one factor that Appeals will take into account in its consideration of the case. Appeals employees independently evaluate the strengths and weaknesses of the specific issues in the cases assigned to them and make an independent judgment concerning the overall strengths and weaknesses of the cases they are reviewing and the hazards of litigation.[37]

If the Service's position in a case or on an issue is adverse to the taxpayer (as it generally is in tax disputes), Appeals may nevertheless partially or fully concede the issue based on the litigating hazards.[38] Indeed, this is the fundamental role of Appeals in our system. Under the Regulations, Appeals enjoys the same independence in cases with taxpayer-

[37] Rev. Proc. 2012-18, 2012-1 C.B. 455, Section 2.06(1).
[38] *See* Reg. § 601.106(f)(2).

adverse technical advice from Counsel (outside the context of exempt organizations). "If the technical advice is unfavorable to the taxpayer, the Appeals office may settle the issue in the usual manner under existing authority."[39]

"Independence," if it means anything, means that Appeals may reach a result that is inconsistent with or contrary to technical advice or rulings issued by Counsel. Even Regulations are sometimes invalidated by the courts. An independent Appeals Division must weigh the risks that Counsel's legal advice, rulings, or even the Service's published guidance may be discounted or rejected by a court as one factor that may affect the hazards of litigation. Delegation Order 8-8, outside the context of exempt organization determinations, gives Appeals full settlement authority over Appeals-jurisdiction cases, whether or not technical advice is in the administrative file.

Transfer pricing cases offer perhaps the best recent example of Appeals Officers asserting their independence in the face of a well-coordinated Service position formulated by Counsel. So far, Appeals' assessment of the hazards of litigation on many of those cases has proved to be reasonable, allowing both Treasury and many taxpayers to avoid costly and counterproductive transfer pricing litigation.

b. <u>New exceptions to the long-standing practice</u>

Notwithstanding the Regulations and the long-standing practice of Appeals, however, section 8.6.3.3 of the Manual now sets out the following exceptions and additional steps Appeals must now take into account before recommending partial or full concessions adverse to a Service position:

- Appeals will not partially or fully concede an issue in a case where the Associate Chief Counsel office has issued a decision with regard to an issue that a court reviews using an abuse of discretion standard (for example, the denial of non-automatic change of accounting method requests (requested on Form 3115)).

- When full concession of an issue is recommended without offsetting concession, and is contrary to a Service position, Appeals must request and consider the views of the appropriate Associate Chief Counsel office function.

- Appeals must coordinate consideration of the issues listed in CCDM Exhibit 31.1.1-1 with the Associate Chief Counsel office.[40]

- If the taxpayer's facts are distinguishable from the facts upon which the Service based its position, Appeals does not have to obtain the views of the Associate Chief Counsel. Generally, this statement applies to a revenue ruling, private letter ruling, or other Service position that was not issued directly to the taxpayer with regard to the year at issue.

[39] Reg. § 601.106(f)(9)(viii)(c).
[40] This Exhibit currently lists dozens of coordination "triggers," including any case of first impression and positions inconsistent with Regulations or other published guidance or rulings.

In the recent open letter, the Chief of Appeals elaborated: "The decision to grant taxpayers an extension to make a regulatory election is left to the Commissioner's discretion, which has been delegated to the Office of Chief Counsel and not to Appeals. Reversing Counsel's decision on a 9100 relief determination has no practical effect without that authority."[41]

c. Difficulty in reconciling published guidance with the new Manual provisions.

We were puzzled to see these changes presented in the Manual. For one thing, these changes to the Manual appear to conflict with the Regulations, which contemplate that Appeals could seek to have a National Office ruling revoked or modified and provide a path for resolving those cases. Regulation section 601.106(f)(9)(i)(d) provides:

> If an Appeals office is of the opinion that a ruling letter previously issued to a taxpayer should be modified or revoked and it requests the National Office to reconsider the ruling, the reference of the matter to the National Office is treated as a request for technical advice…Only the National Office can revoke a ruling letter. Before referral to the National Office, the Appeals office should inform the taxpayer of its opinion that the ruling letter should be revoked.

In the accounting method context, Revenue Procedure 2002-18 provides that an Appeals Officer may resolve an accounting method issue when it is in the interest of the government to do so.[42] The Revenue Procedure also provides Appeals with broad authority in resolving these issues. Accounting method issues may be addressed with an accounting method change (selecting a new method of accounting for the taxpayer and allowing alternative terms and conditions for the change).[43] Even if Appeals chooses not to settle an accounting method issue with an accounting method change, the Revenue Procedure allows the use of an alternative-timing resolution[44] or a time-value of money settlement.[45] Under longstanding practice, Appeals has traditionally resolved accounting method issues without regard to whether the taxpayer had previously requested a non-automatic method change from the National Office. The recent Manual change appears to be in conflict with the Revenue Procedure.

d. Negative impacts of new provisions

Further, because Revenue Procedure 2002-18 offers various settlement alternatives when it is in the government's best interest, we question whether it is prudent to so significantly constrict Appeals' ability to resolve these issues. Under the Manual change, Appeals' alternatives for resolving accounting method issues are limited, which will lead to protracted controversy and increased litigation. Additionally, the incentives currently available to encourage a taxpayer to voluntarily change from an improper accounting

[41] Open letter from Kirsten Wielobob, Chief of Appeals, Internal Revenue Service (November 4, 2016).
[42] Rev. Proc. 2002-18 § 6.01.
[43] *Id*. at § 6.02(2).
[44] *Id*. at § 6.02(3).
[45] *Id*. at § 6.02(4).

method to a proper one would be reduced. We respectfully suggest that the Service more fully consider the implications of these revisions to the Manual.

An additional consideration is that the Manual change creates a standard that cannot be readily implemented. Section 8.6.3.3 of the Manual clarifies that Appeals will not review cases in which the *sole issue* is an abuse of discretion. An abuse of discretion claim is necessarily accompanied by an underlying substantive technical question. Non-automatic accounting method change requests require a substantive basis for the change.[46] Thus, a substantive technical basis is required for any denial. Although the Commissioner has significant discretion in determining a taxpayer's accounting method, including approval or denial of an accounting method change, the Commissioner's discretion is not unlimited.[47] Therefore, whenever an abuse of discretion claim arises as a result of the denial of a non-automatic accounting method change, the claim necessarily involves a review of the technical merits of the accounting method issue.[48] This result is further complicated by the fact that the Service has vastly expanded the scope of automatic accounting method changes such that the overwhelming majority of accounting method changes are now available automatically. As such, non-automatic accounting method changes are limited to those proposed changes that are either technically or procedurally complex. Consequently, the only accounting method changes within the scope of the Manual revisions inextricably link technical and substantive issues with any possible abuse of discretion claim. For this reason, the Manual change sets out a standard that cannot be achieved in practice.

More broadly, we question the wisdom of forsaking Appeals consideration of cases with Counsel abuse-of-discretion guidance in the administrative file. Accounting methods and transfer pricing are just two of the issues subject to abuse-of-discretion review by the courts. We do not believe that Appeals intended to include these cases—and others—in the scope of the Manual revision. Appeals' judgment and independence is certainly warranted in these cases. Some of those cases present significant hazards of litigation for the government.[49]

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[46] *See* Form 3115 (Rev. Dec. 2015), *Application for Change in Method of Accounting* (question 16 requires the applicant to provide a full explanation of the legal basis supporting the proposed method for the item being changed, including all supporting authority (statutes, regulations, published rulings, and cases)).

[47] *See Wright Contracting Co. v. Commissioner*, 36 T.C. 620 (1961), *acq.* 1966-2 C.B. 7, *aff'd*, 316 F.2d 249 (5th Cir. 1963), *cert. denied*, 375 U.S. 879 (1963) (indicating that it would amount to an abuse of discretion for the Commissioner to refuse a request for change from an improper to a proper method); *see also National Bank of Fort Benning v. United States*, 79-2 U.S. Tax Cas. (CCH) P9627 (M.D. Ga.1979) (finding an abuse of discretion when Commissioner refused to grant consent to an accounting method change from an incorrect to a correct one unless the taxpayer accepted terms and conditions not required by section 481). When a taxpayer demonstrates that its method of accounting clearly reflects income, the Commissioner cannot require a change to a different method of accounting, even if such different method, in the Commissioner's view, more clearly reflects income. *Molsen v. Commissioner*, 85 T.C. 485, 498 (1985); *Auburn Packing Co. v. Commissioner*, 60 T.C. 794, 798-99 (1973); *Garth v. Commissioner*, 56 T.C. 610, 618 (1971).

[48] *See e.g., Girling Health Systems v. Commissioner*, 71A AFTR 2d 93-3304 (Cl. Ct. 1990).

[49] *E.g. Mulholland v. United States*, 25 Ct. Cl. 748, 749-50 (1992) (denying defendant's motion for summary judgment in accounting method case); *Vines v. Commissioner*, 126 T.C. 279, 291 (2006) (holding that denial of section 9100 relief was an abuse of discretion); *Wilson v. Commissioner*, 705 F.3d 980, 982 (9th Cir. 2013) (rejecting the Service's claim that section 6015(f) determinations are reviewable on an abuse-of-discretion standard).

Imposing National Office coordination requirements on Appeals Officers compromises Appeals independence. By carving out an exception to the *ex parte* communication rules for National Office attorneys, Revenue Procedure 2012-88 seems to imply that Appeals independence can never be impaired by communication between the two offices. Mandating National Office coordination in certain cases only further compromises Appeals independence. We note that the dozens of National coordination "triggers" set out in the CCDM are inappropriate for Appeals. For instance, Appeals can—and should—consider cases involving interpretations of a regulation where there have been no prior judicial opinions or issues affecting large numbers of taxpayers. While IRS Field Counsel may take one approach in this instance, Appeals should not necessarily take the same one. Appeals and IRS Field Counsel serve different missions.

Independent decision-makers should not coordinate their decisions, especially not with the very people who approved the adjustment that created the tax dispute in the first place. For some time now, Appeals Officers have been subject to these National Office coordination rules, and we have already seen a deleterious effect in some case settlement procedures. Tentative (and some agreed) settlements between taxpayers and Appeals Officers have been rescinded after National Office "coordination." This coordination process generates friction, friction that may hinder independence.

The problem is already clear. In order to maintain their independence, Appeals Officers are put in the untenable position of having to sacrifice other fundamental principles of Appeals practice. For instance, we have already seen workarounds, such as cases where the National Office coordination requirement is avoided by Appeals Officers who insist on a nuisance-value settlement in exchange for a concession by Appeals of a well-established Service position.[50] The Appeals organization should not force its Officers and ATCLs to compromise other core principles in order to maintain their cherished independence.

4. Informal Appeals Issue Coordination

Our members are finding themselves in cases where Appeals Officers and ATCLs tell them that "Appeals must be consistent" on certain issues. For example, we understand that certain software issues in domestic production activities deduction cases will not be settled by Appeals above a certain percentage. The same is true for other issues, like certain excise tax issues. These patterns of issue coordination are not revealed on the publicly available Appeals Coordinated Issue page. Presumably, this coordination is being driven through Appeals management channels. We see several problems with this approach.

First, national issue coordination necessarily takes discretion and judgment away from Appeals Officers, ATCLs, and Settlement Officers. Every case is different. Across-the-board coordinated settlement thresholds force consistency at the expense of independence, judgment, and discretion.

[50] *Cf.* Reg. § 601.106(f)(2) ("No settlement will be made based upon nuisance value of the case to either party."); Policy Statement 8–47; I.R.M. 8.6.4.1.

Second, Appeals no longer seems to be following its own coordination procedures as set out in the Manual. The Appeals Coordinated Issue and Appeals Emerging Issue programs, as outlined in the Manual, benefit from the involvement of interested parties from outside the Service. We recommend that if Appeals management seeks consistency on a given issue, Appeals should publish its preliminary position and rationale in writing, after seeking the views of taxpayers and outside stakeholders.

Third, when Appeals formally coordinates issues, it puts practitioners and taxpayers on notice. Nonpublic, informal issue coordination effectively penalizes practitioners and taxpayers who do not know that Appeals will probably settle an issue at a certain percentage regardless of the facts of a given case. The Service in general, and Appeals in particular, should avoid any hint of creating "private law."

Fourth, Appeals coordination likely pushes the most taxpayer-favorable cases into litigation first, all else being equal. We know of no taxpayers who want to litigate with the Service. On the other hand, business taxpayers regularly evaluate the hazards of litigation on tax positions for financial statement purposes, based on their own facts. If Appeals is "undervaluing" the Service's hazards of litigation on any given case because of an Appeals management decision to impose one-size-fits-all issue coordination, taxpayers with the strongest cases have the most to gain by rejecting the secret, capped Appeals coordinated settlement. Those are the very cases the Service is most likely to face—and lose—first in litigation. Mandating settlement consistency across Appeals is arguably counterproductive from an enforcement perspective, because it disregards the principle that facts win cases.

In summary, we recommend that Appeals management let ATCLs and other Appeals Technical Employees evaluate the hazards on their own cases, assisted as necessary by Appeals technical specialists, taxpayers and their representatives. If Appeals management thinks issue coordination is appropriate in a given situation, we recommend Appeals follow the existing coordination procedures set out in the Manual.

5. Appeals Team Case Leader Settlement Authority

ATCLs are given full settlement authority under Delegation Order 8-8. ATCLs resolve the most complicated and largest-dollar adjustments in Appeals. While Appeals Team Cases are small in number, the adjustments in these cases can be enormous, sometimes running into the billions of dollars. ATCLs often are presented with cases involving the most important strategic compliance issues, at least from Compliance's perspective.

As part of an internal review following a Treasury Inspector General for Tax Administration ("TIGTA") report, Appeals recently identified ATCL unilateral settlement authority as a "control weakness." After consulting with ATCLs, ATCL managers, and others, the Chief of Appeals determined:

> Settlement authority will remain with the ATCLs and Appeals will revise our procedures to make it clear that a manager must review a case prior to an ATCL finalizing a settlement to determine whether the manager has any proposed changes. In contrast to our other workstreams, an ATCL manager will not be accepting or rejecting settlements. If the ATCL and manager disagree about a

> settlement, the next higher level manager supervising ATCL Operations will continue to resolve any disagreement.[51]

We agree with the decision to preserve the ATCLs' unilateral settlement authority. In our view, ATCL settlement authority is a crowning feature, not a weakness, of an independent Appeals function. An independent Appeals official is often the last administrative safeguard of the taxpayer when the taxpayer's rights come in conflict with the enforcement power of the Service.

From our perspective, taxpayers and ATCLs properly assess the hazards in most of their cases—a clear sign the system is working. To cite just one example, a recent TIGTA report shows that ATCLs independently evaluate the issues that come before them, siding with taxpayers in a large sample of transfer pricing examinations. In light of recent litigation, this example shows that a strong cadre of independent ATCLs is vital to the fair operation of our tax system. We hope that all in the Service recognize this point.

6. Appeals Jurisdiction in Docketed Cases

In docketed cases, from 1958 to 1978, Regional Counsel was invited to participate in Appeals settlement conferences, and after 1960, expected to actively participate in those conferences. During this time period, all Appeals settlements in docketed cases required the concurrence of Counsel. Since 1978, however, Appeals has had exclusive settlement jurisdiction over most docketed cases for a period before trial, unless Appeals issued the notice of deficiency. Some of the older revenue procedures allowed for split jurisdiction over a case between Appeals and Counsel. Under the current Revenue Procedure, any given case is either in Appeals or in Counsel's jurisdiction, but never both at the same time.

From 1978 to 1982, Counsel was required to solicit the views of Appeals before Counsel settled designated cases. In 1987, the tables were turned, and high-level Counsel officials were given the right to determine that a case, or issues in a case, should not be considered by Appeals, but only after consulting with the Chief of Appeals and Regional Counsel. Since 2016, the determination that an otherwise Appeals-eligible case shall not be referred to Appeals may be made by more junior Counsel officials than ever before. Furthermore, Counsel is no longer obliged to consult with Appeals beforehand on such cases.

On this issue, we understand and appreciate that many of the recommendations in recent comments we submitted in response to Notice 2015-72 were incorporated into Revenue Procedure 2016-22. That Revenue Procedure also notes that "[a] number of the suggestions that were not adopted in the revenue procedure may be addressed in the Internal Revenue Manual, the Chief Counsel Directives Manual, or in training." A number of our comments fall into this category, and while we do not restate them here, we hope that they will indeed be reflected in the Manual, a directive, or some other public source in the near future.

In particular, we are aware of at least one instance in which Counsel recently invoked section 3.03 of Revenue Procedure 2016-22 to keep a docketed case from Appeals on the

[51] Wielobob, Open Letter, *supra* note 41.

grounds of "sound tax administration." The reasons behind that decision were not explained to the taxpayer involved and it was unclear what role (if any) Appeals played in that decision. This example reinforces the need for further guidance, as mentioned in our prior comments, that would continue the checks and balances that were part of the procedures in Revenue Procedure 87-24 (requiring consultation with Appeals before a decision was made to deny Appeals consideration of a taxpayer's case), provide procedures for taxpayer input similar to those in the designation process under section 33.3.6.2 of the Manual, and distinguish the standard used for these types of decisions from the standard used to designate a case for litigation (each of which refers to "sound tax administration").

Conclusion

We appreciate the opportunity to provide these Comments. As noted above, if you believe it would be helpful, we would welcome the opportunity to meet with the appropriate personnel from Appeals to discuss these Comments.