

BY JONI LARSON

# The IRS's Push

Over the past two years, the IRS has launched several new programs touted as opportunities for quickly resolving disagreements between the IRS and taxpayers. These new programs, combined with prior-existing programs and increased powers given to the Taxpayer Advocate, give taxpayers a number of avenues before, during, and after the audit through which issues can be resolved.

## BEFORE THE AUDIT

### Pre-Filing Agreements

The Pre-Filing Agreement Program was launched in 2000. It is intended to resolve controversies before the tax return is filed. Specifically, the taxpayer undergoes an examination of specific issues before timely filing the tax return.<sup>1</sup> To be accepted into the program, the taxpayer must be under the jurisdiction of the Large and Mid-Size Business Division (LMSB),<sup>2</sup> the issue must be an eligible issue, and the year must be an eligible year. In addition, those taxpayers accepted into the program must pay a user fee.<sup>3</sup>

Only issues that are factual and involve the application of well-settled principles of law will be considered.<sup>4</sup> Furthermore, the IRS

has criteria it considers in deciding whether to accept a taxpayer, such as: the suitability of the issue; the direct or indirect impact of a pre-filing agreement on other years, issues, taxpayers, or related cases; the ability and willingness of the taxpayer to dedicate sufficient resources to the process; and the probability of completing the examination of the issue and entering into an agreement by the target date.<sup>5</sup>

Eligible years include the current taxable year and any prior taxable year for which the return is not yet due (including extensions) and is not yet filed.<sup>6</sup> However, there must be sufficient time prior to the filing date to complete the pre-filing agreement process.<sup>7</sup>

If the taxpayer and the IRS are able to resolve the examined issues prior to filing the return, they will finalize their agreement by executing a specific matter closing agreement covering a specific time period.<sup>8</sup> If an agreement is not reached until after the return is filed, the results may be incorporated into an audit report or the taxpayer may file an amended return.<sup>9</sup> Acceptance into the program does not suspend or waive the normal filing requirements for tax returns that may be affected by the program.<sup>10</sup>

In 2003, 42 applications were received. In 2002, 44 applications were received, 25 were accepted, and 18 pre-filing agreements were executed.<sup>11</sup> More information on Pre-Filing Agreements can be found in Revenue Procedure 2001-22 or at [www.irs.gov](http://www.irs.gov). Click on "Businesses," "Information for Large to Mid-Size Businesses," then "Pre-Filing Agreement Program."

### Industry Issue Resolution Program

The Industry Issue Resolution (IIR) Program, launched as a pilot program in 2000 and made permanent in 2002, is intended to resolve issues on an industry-wide, as opposed to taxpayer-by-taxpayer, basis. It focuses on issues that are frequently disputed or burdensome and affect a significant number of business taxpayers.<sup>12</sup> Taxpayers, as well as industry associations and other groups representing taxpayers, can suggest issues and possible options for resolution.<sup>13</sup> However, an issue accepted into the program will likely have at least two of the following characteristics:<sup>14</sup>

- The proper tax treatment of a common factual situation is uncertain;
- The uncertainty results in frequent, often repetitive, examinations of the same issue;



***New programs provide opportunities for resolving disagreements***

# Towards Settlement

- The uncertainty results in significant taxpayer burden;
- The issue is significant and impacts a significant number of taxpayers, either within an industry or across industry lines; or
- The issue requires extensive factual development, and an understanding of industry practices and views concerning the issue would assist the IRS in determining the proper tax treatment.

Once the issues are submitted, the IRS in conjunction with the Department of Treasury evaluates the suggestions and attempts to select issues from different industries.<sup>15</sup> In reviewing potential issues for the IIR, the government will consider the suitability of the issue for the program, the likelihood that timely guidance can be provided, and the availability of appropriate staffing and other resources.

Issues are selected semi-annually, and those selected are announced publicly. When issued, the guidance will likely be in the form of a Revenue Procedure or Revenue Ruling.<sup>16</sup> Issues confronting the banking and heavy equipment distributor industries were selected for guidance in 2004. Additional information on the IIR program can be obtained from Revenue Procedure 2003-36 or from the IRS website, [www.irs.gov](http://www.irs.gov). Select "Businesses" then "Industry Issue Resolution Program."

## Advance Pricing Agreement

The Advance Pricing Agreement (APA) Program has been around for many years. Like the Pre-Filing Agreement Program, it provides a taxpayer and the IRS a mechanism for resolving factual issues prior to fil-

ing the return. However, the APA Program applies only to international transfer pricing cases; the taxpayer and IRS attempt to reach an agreement on the appropriate transfer pricing methodology to be applied in related party transactions.

APA agreements can be unilateral or bilateral. In a unilateral APA, the taxpayer and the IRS reach an agreement. In a bilateral APA, the agreement between the taxpayer and the IRS is combined with an agreement between the United States and one or more foreign tax authority.

To participate in the program, the taxpayer must submit an application and a user fee.<sup>17</sup> In the application, the taxpayer will propose a transfer pricing methodology and provide data to support it as the best method.<sup>18</sup> In most instances, the APA application is a substantial document filling several binders. Expedited procedures are available for small businesses and renewals of existing APAs.<sup>19</sup>

The APA team will review the relevant facts submitted by the taxpayer to determine if they are complete and accurate. When that review is concluded, the APA team will begin negotiations with the taxpayer over the various aspects of the APA. In a unilateral APA case, the taxpayer and the APA Team must reach an agreement to conclude the APA.

In a bilateral APA case, the negotiations proceed in two parts and involve two IRS offices—the APA Program and the U.S. Competent Authority.<sup>20</sup> First, the APA team will attempt to reach a consensus with the taxpayer regarding the recommended position that the U.S. Competent Authority should take in negotiations with its treaty partner.

The recommended position provides the APA Program's view of the best transfer price methodology for the covered transaction, taking all factors into account.

Then, the APA process shifts from the APA Program to the U.S. Competent Authority. A U.S. Competent authority analyst prepares the final U.S. negotiating position, which is then transmitted to the foreign competent authority. The negotiations with the foreign competent authority are conducted by the U.S. Competent Authority analyst, most often in face-to-face negotiating sessions conducted periodically throughout the year.

Because the APA program has developed standard language that is incorporated into every APA, after the IRS and the taxpayer reach agreement, the drafting of the final APA generally takes little time. An executed APA is binding on the taxpayer and the IRS.<sup>21</sup> More information on the APA Program can be found on the IRS website. Click on "Businesses," "Information for Large to Mid-size Businesses," "International Businesses," and "Advance Pricing Agreement Program."

## DURING THE AUDIT

### The LIFE Program

The Limited Issue Focused Examination (LIFE) Program is a new process that results in the creation of a joint audit plan. The objective of the program is to shorten the examination time by obtaining the cooperation of the taxpayer from the outset. It is available only to taxpayers under the jurisdiction of Large and Mid-Size Business and only if the IRS offers the taxpayer the opportunity.

In general, the IRS will review the entire return and determine which are the material issues it will audit. Based on that review, the IRS will agree not to raise issues below a specific dollar amount and in return the taxpayer must agree to not file claims for refund. In addition, the IRS expects the taxpayer to be a responsive and accountable participant in the examination process.

If accepted into the program, the IRS and taxpayer will develop a joint, issue-driven, audit plan. The agreed-upon audit plan will be reflected in a Memorandum of Understanding.<sup>22</sup> More information on the Limited

Issue Focused Examination Program can be obtained from the IRS website. Click on "Businesses," then "Information for Large to Mid-Size Businesses" and then "Limited Issue Focused Examination Program (LIFE)."

### Technical Expedited Advice Memoranda

Technical advice is written advice or guidance in the form of a memorandum furnished by the National Office upon request of a director in a nondocketed<sup>23</sup> case.<sup>24</sup> The advice assists the IRS in resolving cases and establishing and maintaining consistent holdings on issues throughout the IRS.<sup>25</sup> It addresses novel or complex legal issues where the IRS's position has not been previously established<sup>26</sup> and sets forth what the IRS understands to be the proper interpretation and application of the tax laws to the facts of the specific case. When rendered, it represents a final determination of the position of the IRS with respect to a specific issue in a specific case.<sup>27</sup>

Revenue Procedure 2004-2<sup>28</sup> explains when and how the National Office will give technical advice to a director. It also explains the rights of the involved taxpayer.<sup>29</sup> A director can request technical advice by submitting a request to the National Office.<sup>30</sup>

Technical Expedited Advice Memorandum (TEAM) procedures, launched as a pilot program in 2002 and made permanent in 2003, help expedite the Technical Advice Memorandum process and eliminate some requirements that delay or frustrate the process.<sup>31</sup> In short, it is a Technical Advice Memorandum issued in an expedited manner.<sup>32</sup>

If there is agreement among the taxpayer, the field office, and the National Office, a request for technical advice can be submitted under the TEAM procedures.<sup>33</sup> Generally, the same procedures for submitting a request for a Technical Advice Memorandum apply to submitting a request for a TEAM, with some shortening of the time frames. The National Office attempts to issue all TEAMS to the field within 60 calendar days of receipt.

### AFTER THE AUDIT

The Fast Track Mediation (FTM) Program, launched as a pilot program in 2001 and made permanent in 2003, is designed to expedite case resolution and expand the

range of dispute resolution options available to taxpayers.<sup>34</sup> The parties can initiate FTM only after the conclusion of an examination or collection determination.<sup>35</sup> The program is optional for the taxpayer and does not replace existing appeal rights.<sup>36</sup> An Appeals Officer who has been trained in mediation acts as a neutral party.<sup>37</sup>

It is generally available for all non-docketed cases and collection source work over which Small Business/Self-Employed has jurisdiction, including offer in compromise, trust fund recovery penalty, and collection due process cases. It is not available for issues for which resolution will depend on an assessment of the hazards of litigation and require the Appeals Official to use delegated settlement authority.<sup>38</sup> The goal is to resolve the case within 30 to 40 days from the initial joint discussion between the FTM Appeals Official and the parties.<sup>39</sup>

*The code is often not black and white, and taxpayers legitimately may disagree with the IRS's interpretation of a code section.*

The program is also generally available for all cases over which Large and Mid-Size Business has jurisdiction, except those cases that contain an issue designated for litigation, a whipsaw issue, or an issue for which mediation would not be consistent with sound tax administration (e.g., issues governed by closing agreements, by res judicata, or by controlling precedent).<sup>40</sup> The goal is to resolve the case within 120 days of acceptance into the program.<sup>41</sup>

More information on the program can be obtained from Revenue Procedure 2003-40 and Revenue Procedure 2003-41 or Publica-

tion 3605, Fast Track Mediation—A Process for Prompt Resolution of Tax Issues.

### NATIONAL TAXPAYER ADVOCATE

Through the Restructuring and Reform Act of 1998, the Office of the Taxpayer Advocate was given greater responsibilities and powers by providing for local taxpayer advocates who report to the National Taxpayer Advocate.<sup>42</sup> The Office of the Taxpayer Advocate represents taxpayers' interests and concerns by participating in major program and policy deliberations within the IRS decision-making process. It is headed by the National Taxpayer Advocate (NTA), who reports directly to the commissioner. The main role of the NTA is to protect individual taxpayer's rights and reduce the taxpayer's burden.<sup>43</sup>

Through the process called "systemic advocacy," the Office of the Taxpayer Advocate identifies those areas in which many taxpayers have similar or common problems in dealing with the IRS. It then attempts to solve those problems on a wholesale basis by proposing administrative and legislative changes that will prospectively eliminate the problem for all similarly-situated taxpayers. To carry out this responsibility, the commissioner has delegated to the NTA the authority to issue a Taxpayer Advocate Directive (TAD), which addresses a system-wide administrative or procedural problem affecting many taxpayers. The TAD must address a process or procedure that creates undue burden, infringes upon the rights of taxpayers, or results in inequitable treatment of taxpayers.<sup>44</sup> To suggest a problem area that could be addressed through systemic advocacy, log onto the IRS website at [www.irs.gov](http://www.irs.gov). Click on "Taxpayer Advocate," then "What is Systemic Advocacy?" and follow the instructions.

Through the process called "casework advocacy," the Office of the Taxpayer Advocate attempts to immediately solve problems on a taxpayer-by-taxpayer basis. To qualify for such help, the taxpayer must face a "significant hardship" caused by the manner in which the IRS administers the tax laws.<sup>45</sup>

If the Office determines a taxpayer is in fact suffering a significant hardship and is properly entitled to relief, the NTA can issue a Taxpayer Assistance Order (TAO) to an IRS operating division.<sup>46</sup> A TAO can either

## Fast Facts:

**The Industry Issue Resolution Program is intended to resolve issues on an industry-wide, as opposed to taxpayer-by-taxpayer, basis.**

**The Fast Track Mediation Program is designed to expedite case resolution and expand the range of dispute resolution options available to taxpayers.**

**The Office of the Taxpayer Advocate identifies those areas in which many taxpayers have similar or common problems in dealing with the IRS.**

be a Direct TAO or a Review TAO. In a Direct TAO, the TAO orders the IRS to take an action or to cease an action. In a Review TAO, the TAO orders that the organizational unit with primary responsibility for a taxpayer's case expedite consideration of the case, reconsider its determination in the case, or review the case at a higher level of that organizational unit. A taxpayer can request a TAO from the NTA by submitting a Form 911, Application for Taxpayer Assistance Order (ATAO).

Local taxpayer advocates represent taxpayers located in the area served by the local office, the Taxpayer Assistance Center. At least one local advocate is available in each state.<sup>47</sup> In addition, the National Taxpayer Advocate Toll-Free Line provides cost-free access to the Taxpayer Advocate Service for issues that have not been resolved through the IRS's normal channels. The service is available to taxpayers 24 hours a day, seven days a week. The number is 1-877-777-4778.

## CONCLUSION

The IRS has created a number of tools that are available during every stage of the audit process to resolve cases as early and quickly as possible. However, the code is often not black and white, and taxpayers legitimately may disagree with the IRS's interpretation of a code section. Furthermore, the taxpayer is free to advocate any reasonable interpretation that supports his position. If the taxpayer is intent on gaining judicial support for his position, no number of settlement tools will discourage him from litiga-

tion. For all others, however, the roads to settlement are numerous. ♦

*Joni Larson is an Assistant Professor of Law at Thomas M. Cooley Law School. She teaches in the LL.M. tax program. She received her B.A. in 1986 and J.D. in 1989 from the University of Montana and her LL.M. in Taxation in 1990 from the University of Florida. Ms. Larson is a member of the Michigan, Montana, Washington State, and Washington, D.C., bars.*

## Footnotes

1. Sec. 1.01, Rev. Proc. 2001-22, 2001-1 C.B. 745.
2. The Large and Mid-Size Business Division serves corporations and partnerships with assets greater than \$10 million.
3. Sec. 10.01, Rev. Proc. 2001-22. The user fees are based on the value of the assets held by the taxpayer based on its most recently filed tax return. Sec. 10.02, Rev. Proc. 2001-22.
4. Sec. 1.03, Rev. Proc. 2001-22. The Revenue Procedure sets forth a nonexclusive list of issues the IRS considers likely to be suitable for resolution and those on which it will not enter into a pre-filing agreement. See Sec. 3.04, 3.05, and 3.06.
5. Sec. 5.02, Rev. Proc. 2001-22.
6. Sec. 3.02, Rev. Proc. 2001-22.
7. Sec. 3.02, Rev. Proc. 2001-22.
8. Id. See also IRC 7121.
9. Sec. 6.06, Rev. Proc. 2001-22.
10. Sec. 6.03, Rev. Proc. 2001-22.
11. Announcement 2003-43, 2003-26 IRB 1139.
12. Sec. 1, Notice 2002-20, 2002-17 IRB 796.
13. Sec. 1, Notice 2002-20. All submissions are made available to the public.
14. Sec. 2, Notice 2002-20. Issues that are considered not appropriate for the program include issues unique to one or a small number of taxpayers; issues under jurisdiction of Tax Exempt/Government Entities Division (e.g., employee plans); issues regarding transactions that lack a bona fide business purpose or are done with significant purpose of reducing or avoiding federal taxes; and issues involving transfer pricing or international treaties.
15. Sec. 4, Notice 2002-20.

16. Sec. 1, Notice 2002-20.
17. Sec. 4, Rev. Proc. 2004-40, 2004-29 IRB 50. The amount of the user fee is set forth in sec. 4.12, Rev. Proc. 2004-40.
18. Secs. 4.02, 4.03, Rev. Proc. 2004-40.
19. Secs. 8, 11, Rev. Proc. 2004-40. A small business taxpayer is a taxpayer with gross income of \$200 million or less. Sec. 8.01, Rev. Proc. 2004-40.
20. See Sec. 6, Rev. Proc. 2004-40 and Rev. Proc. 2002-52, 2002-2 C.B. 242.
21. Sec. 9.01, Rev. Proc. 2004-40.
22. A sample MOU has been released by the IRS and is available on its website.
23. A nondocketed case is one in which the IRS has not issued a notice of deficiency and the taxpayer has not filed a petition or complaint.
24. Sec. 1.02, Rev. Proc. 2004-2, 2004-1 IRB 83; Chief Counsel Directives Manual CCDM 39.7.3(1).
25. Treas. Reg. § 601.105(b)(5)(i)(a); Chief Counsel Directives Manual CCDM 39.7.1.1; 39.7.1.3(2).
26. Treas. Reg. § 601.105(b)(5)(ii)(b); Chief Counsel Directives Manual CCDM 35.2.7.4.2(2)c.
27. Chief Counsel Directives Manual CCDM 35.2.7.4.2(2)a.
28. The procedures for requesting technical advice are always issued in the second revenue procedure of the year. Sec. 1.05, Rev. Proc. 2004-2, 2004-1 IRB 83.
29. Sec. 1, Rev. Proc. 2004-2.
30. Treas. Reg. § 601.105(b)(5)(ii)(a). The issue cannot be in a docketed case for any year. Sec. 6.03, Rev. Proc. 2004-2.
31. Sec. 3, Rev. Proc. 2004-2.
32. Id.
33. Sec. 7, Rev. Proc. 2004-2. If the taxpayer does not want to participate in the request, generally the request will be treated as a request for technical advice. Id.
34. Sec. 1, Rev. Proc. 2003-40, 2003-25 IRB 1044; Sec. 1, Rev. Proc. 2003-41, 2003-25 IRB 1047.
35. Sec. 3, Rev. Proc. 2003-40; Sec. 4.02, Rev. Proc. 2003-41.
36. Sec. 2.02, Rev. Proc. 2003-40; Sec. 2.02, Rev. Proc. 2003-41.
37. Sec. 5.01, Rev. Proc. 2003-40; 5.02, Rev. Proc. 2003-41.
38. Sec. 3.01, Rev. Proc. 2003-41.
39. Sec. 2.01, Rev. Proc. 2003-41.
40. Secs. 3.02, 3.03, Rev. Proc. 2003-40, 2003-25 IRB 1044.
41. Sec. 2.01, Rev. Proc. 2003-40.
42. IRC 7803(c)(2)(C), (c)(4).
43. IRC 7803(c).
44. Delegation Order No. 250, 63 Fed. Reg. 25567.
45. A significant hardship includes an immediate threat of adverse action; a delay of more than 30 days in resolving taxpayer account problems; the incurring by the taxpayer of significant costs if relief is not granted; or irreparable injury to, or a long-term adverse impact on, the taxpayer if relief is not granted. IRC 7811(a)(2); Reg. § 301.7811-1(a)(4).
46. IRC 7811(a). A TAO is not designed to provide more efficient service to taxpayers in cases where there is not disagreement within the IRS about the appropriate action that should be taken in the case.
47. IRC 7803(c)(2)(D)(i)(I).