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KPMG in the US

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Resolving disputes in IRS Appeals

Mark Martin and Thomas Bettge of KPMG in the US discuss the IRS Appeals process, including recent developments that affect how Appeals functions.

In the Taxpayer First Act of 2019, Congress rebranded the IRS Appeals Office as the IRS Independent Office of Appeals (Appeals), intending to secure access to Appeals for taxpayers and to cement it as a dispute resolution forum independent of the IRS examination function. Recently, as discussed in another article, the Government Accountability Office (GAO) found that IRS alternative dispute resolution programmes have been severely underutilised, leaving the vast majority of disputes in the traditional track from IRS examination to Appeals and litigation. The underutilisation of alternative programmes means that traditional Appeals is comparatively overutilised, and makes it worthwhile to consider developments that affect how Appeals functions.

Appeals in brief

At the conclusion of an unagreed IRS examination, the taxpayer has the option to file a protest and take the case to IRS Appeals instead of proceeding directly to litigation. An Appeals officer will then hold a conference with the taxpayer and conduct settlement negotiations. One issue in recent years has been the inclusion of IRS examination personnel in the non-settlement portion of Appeals conferences, which can affect the tenor of the process and blur the lines between traditional Appeals and mediation-based programmes.

In addition to providing access to a new set of eyes, Appeals unlocks a possibility not available when settling cases at the examination level: consideration of the hazards of litigation. This can be beneficial, as it allows the IRS to concede, or partially concede, issues based on likely outcomes in litigation, even if the IRS does not agree with the underlying position.

Yet hazards cut both ways. In recent years, some experiences suggest that it is more difficult to gain a full concession from IRS Appeals even on issues where the taxpayer is plainly correct, with Appeals officers proposing to retain a portion of the adjustment to reflect the hazards of the taxpayer losing in litigation.

Mutual agreement procedures

Appeals comes with other potential pitfalls. Historically, taxpayers with cross-border tax issues eligible for treaty relief could take a case to Appeals and, to the extent Appeals did not eliminate the IRS-initiated adjustment, could then pursue bilateral relief via the mutual agreement procedure (MAP). Since 2015, however, the ability to take a case to Appeals prior to a MAP has been eliminated except in very specific circumstances; namely, where the taxpayer severs the MAP issue from the Appeals process within 60 days of the Appeals opening conference.

Appeals consideration of MAP issues can be obtained via the simultaneous appeals process (SAP) under the jurisdiction of the US competent authority, but an effective SAP can be difficult to coordinate because of resource constraints and competing timelines for Appeals and the competent authority.

An important consideration is the relative success rates and timing of MAP and Appeals processes.

The GAO found that over the ten fiscal years prior to 2023, Appeals cases took on average 389 days to resolve, and resulted in full resolution in 59% of cases and partial resolution in another 10%. Full resolution does not mean that the taxpayer's position prevailed, but rather that the taxpayer and the IRS were able to settle all the covered issues in the Appeals case.

By comparison, a MAP is generally much more effective at eliminating double taxation: when adjusting the statistics for cases that do not reflect substantive MAP dispositions, success rates for the US competent authority are generally over 90%. However, MAP cases take longer, often in excess of two years.

The independence of Appeals

Then, too, there are issues for which Appeals consideration is no longer available as of 2022, when new proposed regulations were promulgated. While the proposed regulations purport to reflect changes made in the Taxpayer First Act, certain aspects of the regulations do more to undermine the act's emphasis on the independence of Appeals.

Under the proposed regulations, Appeals will not consider arguments concerning the constitutionality of statutes or the validity of Treasury regulations, revenue procedures, or notices, absent an unreviewable federal court decision invalidating the item in question. In an era when a significant amount of federal tax controversy revolves around precisely these questions, a blanket rule preventing Appeals from considering these issues is not conducive to effective tax administration, especially in cases where there is a court decision on point that is continuing through appellate litigation (and thus not yet "unreviewable" within the meaning of the rule) or addressing an analogous statute or regulation.

The rule also undermines Appeals' independence. Part of the rationale for the rule is that regulations and IRS guidance have already been approved by senior officials, but the *raison d'être* of the IRS Independent Office of Appeals is that it should be independent of the rest of the IRS – those officials included.

A key question for taxpayers considering action

Appeals continues to play a key function in the dispute resolution system, but taxpayers considering their options should consider carefully whether Appeals is the best forum. Underutilised as they are, some of the IRS's alternative dispute resolution options – notably, Fast Track Settlement – can offer some of the benefits of Appeals on an expedited timeline. Other issues are more susceptible to resolution in MAPs, now that taxpayers cannot practically pursue sequential Appeals and MAP cases.

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