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Gaps In The IRS Appeals Reform Proposal

By **Saul Mezei and Michael Kummer** (April 19, 2019, 12:10 PM EDT)

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The Taxpayer First Act of 2019 is pending, bipartisan legislation intended to "redesign the IRS" to "better serve taxpayers."[1]

The act proposes a host of changes, including enhancing the IRS' ability to prevent identity theft in the tax-refund context and requiring the U.S. Department of the Treasury to submit to Congress plans to improve the IRS' customer-service capabilities. The act's goals are lofty and important for effective tax administration. It is therefore not surprising that that act has garnered wide bipartisan support.

This article focuses on one aspect of the act — Section 1001 — which would amend Internal Revenue Code Section 7803 by adding a new subsection (e). The purpose of that amendment is to ensure the laudable goal "that generally all taxpayers are able to access" the IRS Office of Appeals and potentially resolve their disputes with the IRS administratively (i.e., without litigation).

New Section 7803(e)(1) would rename the IRS Office of Appeals the "Independent Office of Appeals."[2] But new Section 7803(e) appears designed to remedy a discrete scenario that not many taxpayers face. As a result, it raises questions and leaves gaps that Congress should consider and address before Section 1001 of the act (or something like it) becomes law.

Background on Section 1001

Several recent legislative efforts have proposed changes designed to ensure greater access to the Office of Appeals. In 2016, Sen. Rob Portman, R-Ohio, proposed legislation in the Senate that would have codified taxpayers' right to access the Appeals Office.[3] Rep. Jason Smith, R-Mo., subsequently proposed similar legislation in the House.[4] These legislative efforts — and others like them — failed.

The aforementioned legislative efforts followed public disputes regarding Revenue Procedure 2016-22, which addresses the Appeals Office's review of docketed Tax Court cases. The revenue procedure allows the IRS to refuse to refer a docketed U.S. Tax Court case to the office if the referral is "not in the interest of sound tax administration."[5]

The IRS finalized Revenue Procedure 2016-22 despite the concerns of commenters, including

the American Bar Association.[6] It did not take long for the IRS to use the revenue procedure against a taxpayer in a well-publicized dispute.

In late 2017, Facebook Inc. — which was denied access to the Appeals Office under Revenue Procedure 2016-22 during Tax Court litigation — sued the IRS in the U.S. District Court for the Northern District of California. Facebook claimed an Administrative Procedure Act, or APA, violation on the basis that the IRS improperly refused to refer its case to the Appeals Office; the company also sought mandamus-like relief (i.e., an order that the IRS refer its case to the office).[7]

In May 2018, the district court issued an opinion holding that Facebook did not have an enforceable right to take its case to the Office of Appeals and dismissing the case.[8]

Soon thereafter, the national taxpayer advocate explained in her report to Congress that "[a] robust administrative dispute resolution program represents an indispensable element of effective tax administration" and that a "fundamental aspect" of the Office of Appeals is "to reach mutually acceptable settlements with taxpayers" without having to "resort to litigation."[9] She urged Congress to strengthen the right to appeals.[10]

On March 28, 2019, the Taxpayer First Act was introduced in the Senate as S. 928 and in the House as H.R. 1957. The act currently appears to be on a fast track — it passed on a voice vote in the House on April 9, 2019, and Senate Finance Committee Chairman Chuck Grassley, R-Iowa, expressed optimism that it would pass the Senate "in a timely manner and with broad support."[11]

The act's goals rightfully have broad support. But Section 1001 of the act — perhaps because it was responding to narrow problems, including the one highlighted in the Facebook case — raises several issues Congress should consider carefully before the act becomes law.

The Act's Procedural Protections Are Limited to Taxpayers Who Have Received a Notice of Deficiency

The district court in Facebook held that taxpayers lack an enforceable right to take their tax disputes to the Office of Appeals.

New Section 7803(e)(3) provides that the purpose of the office is to "resolve [f]ederal tax controversies without litigation" on a basis that is fair to the government and taxpayers, promotes consistent application and interpretation of (and voluntary compliance with) the federal tax law, and enhances public confidence in the IRS' integrity and efficiency.

New Section 7803(e)(4) states that the Appeals Office "resolution process" described in Section 7803(e)(3) shall be "generally available to all taxpayers."

The act backstops these provisions with procedures — found in new Section 7803(e)(5) — designed to limit "designation of cases as not eligible for referral to" the Appeals Office. In short, the procedures require the IRS to (1) provide taxpayers with a written notice describing the basis for, and a "detailed explanation" of, a decision to deny a request for Appeals review and (2) create procedures for protesting to the commissioner the IRS' denial of a request for Appeals Office review. But the procedures apply only to "any taxpayer which is in receipt of a notice of deficiency" that "requests referral to" the Office of Appeals.

A taxpayer in receipt of a notice of deficiency has 90 days to petition the Tax Court. That time limit is

jurisdictional, and requesting appeals review will not toll it.[12] Taxpayers such as Facebook will typically prefer to docket their cases in Tax Court rather than forgoing Tax Court review. In other words, Congress proposes procedural safeguards that as a practical matter apply only to taxpayers already involved in Tax Court litigation. Limiting procedural safeguards to docketed Tax Court cases seems problematic for a number of reasons.

First, it seems oddly incompatible with the office's mission — to "resolve cases without litigation" — to guarantee procedural safeguards protecting the right to access the Appeals Office only to taxpayers already in litigation.

Second, limiting procedural safeguards to docketed Tax Court cases unnecessarily consumes Tax Court, taxpayer and IRS resources. As the taxpayer advocate noted, a robust appeals process helps "preserve[] the resources of both taxpayers and the IRS."[13]

But, in docketed cases under review at the Appeals Office, the IRS instructs its trial attorneys to "continue with trial preparation, which may include, but is not limited to, asking the taxpayer to participate in informal discovery."[14] And any docketed Tax Court case also consumes Tax Court resources, even if the court is involved only to the extent it orders and reviews status reports.

Third, because Tax Court proceedings are generally public,[15] the act does not guarantee taxpayers procedural protections until after the IRS forces them into the public sphere. This is unfair to taxpayers who might wish to resolve cases confidentially during the administrative process.

Fourth, the mere presence of a court and assigned trial counsel could make taxpayers and IRS inherently more litigious, which is antithetical to the Office of Appeals' goal of resolving cases amicably. Indeed, under current practice, IRS trial counsel "may request to be included in" an Appeals Office conference with the taxpayer.[16]

The fact that a case is already docketed might also make the office less likely to settle the case because it would not then have to prepare and issue a notice of deficiency (as it typically does when a deficiency case reaches it in the normal course). If the Office of Appeals cannot resolve the docketed Tax Court case, the case would simply continue on its normal course through the litigation.

Fifth, by limiting the act's protective measures to taxpayers "in receipt of a notice of deficiency," the act ignores taxpayers in a refund posture. Under current practice, taxpayers whose claims for refund have been denied can seek — but are not guaranteed — Appeals Office review.[17]

While the act arguably applies to taxpayers who receive a notice of deficiency and then pay the asserted tax, Congress did not explain why it chooses to discriminate among taxpayers based on whether they contest a deficiency in response to a notice of deficiency or pay the tax at some earlier point and then contest the tax via a refund claim and suit.[18]

It is possible that Congress contemplated these issues, assumed that the grant of Appeals Office access in new Section 7803(e)(4) was generally sufficient, and deliberately decided to limit procedural protections to cases in which a notice of deficiency has been issued.[19]

But that would also raise vexing questions, including whether a taxpayer that has not received of a notice of deficiency now has a substantive remedy in district court (i.e., the one denied to Facebook on

the basis that there was no right to access the Office of Appeals) while a taxpayer in receipt of a notice of deficiency is limited to the procedural path contemplated in new Section 7803(e)(5).

Congress could resolve these issues[20] by providing the act's protections to any taxpayer who has requested Appeals Office consideration after receiving a notice of proposed deficiency (e.g., a 30 day letter or similar document), a notice of a denied refund claim or a notice of a similar adverse determination. Indeed, prior legislation aimed at ensuring greater Appeals access sensibly pursued some variation of this approach.[21]

At a minimum, such a change would expand the act's safeguards to taxpayers in a refund posture or who have not yet received a notice of deficiency.[22] But, perhaps most importantly, such a change would best encourage prelitigation review by the Office of Appeals — the essence of the office's long-standing mission.

The Act Is Strangely Silent Regarding Remedies for Noncompliance

While the act establishes safeguards when taxpayers with docketed Tax Court cases are denied Appeals Office consideration and requires the IRS to create procedures for protesting such denials, the act contains no enforcement mechanism to ensure the IRS follows the safeguards or procedures.[23] This might leave some aggrieved taxpayers in the onerous position in which Facebook found itself — litigating a case in Tax Court on the one hand and, on the other, pursuing access to the Office of Appeals by filing an APA-based action in a district court.

Forcing taxpayers to file a parallel APA action appears cumbersome and inefficient. But the Tax Court is a court of limited jurisdiction (i.e., it only has the jurisdiction Congress gives it).[24] The Tax Court could well conclude that it lacks the power to oversee compliance with Section 7805(e)(5) in cases before it. Therefore, Congress could clarify that a court with jurisdiction over a taxpayer's case — such as the Tax Court in a deficiency case or a district court or the U.S. Court of Federal Claims in a refund case — has jurisdiction to determine and remedy any noncompliance with the act that relates to the taxpayer's case.

Furthermore, while the act requires the IRS to "prescribe procedures for protesting to the [c]ommissioner ... a denial of a request" for review by the Appeals Office, the act is silent on whether the commissioner's determination regarding such a protest is — or should be — subject to further review. The ultimate decision might well be committed to the commissioner's discretion (and not subject to judicial review). But silence on this issue could invite litigation by taxpayers who are denied access to the office under the terms of the act where those denials are upheld by the commissioner.

Congress could save taxpayers, the IRS and courts time and effort by clarifying whether the commissioner's determination regarding a protest is itself reviewable. Indeed, the Tax Court noted in dicta in a recent opinion that it would "inevitably" be confronted with questions similar to those Facebook raised in district court (i.e., whether Congress meant to grant new enforceable rights in enacting a new law — in that case the Taxpayer Bill of Rights).[25] Congress can (and should) attempt to mitigate similar questions with respect to the act by taking a careful approach.

The Act's Administrative-File Disclosure Regime Raises Several Questions

The act proposes to "provide[] taxpayers access to the 'case against them.'"[26] New Section 7803(e)(7) would require the Appeals Office to ensure taxpayers are "provided access to the nonprivileged portions

of the case file on record regarding the disputed issues" not later than 10 days before a conference. These provisions raise a number of issues.

First, the act imposes no administrative-file disclosure obligations on the IRS when it denies a taxpayer's request for Appeals Office review. But, given the act's purpose, a disclosure requirement might make even more sense in that context.

If taxpayers have access to their administrative files, they might be able to better assess the merits of the written notice denying them access to the Office of Appeals. Access to administrative files would also help taxpayers protest to the commissioner denials of access to the office by giving them access to some of the files available to the commissioner.

Second, the administrative-file access provisions apply only "in any case in which a conference with [Appeals] has been scheduled upon request" of a taxpayer. It is unclear whether this refers to conferences scheduled under new Section 7803(e)(5) — i.e., when a taxpayer in receipt of a notice of deficiency requests review by the Appeals Office — or if it applies more broadly — i.e., when the IRS affords a taxpayer access to the Office of Appeals before issuing a notice of deficiency. Congress presumably intended the latter.

Third, the provisions apply only to individual taxpayers with adjusted gross income of less than $400,000 for the year in issue or entities with gross receipts of less than $5 million for the year in issue. This is likely because Congress assumed that taxpayers with greater resources are more capable of seeking information another way — such as by filing a Freedom of Information Act, or FOIA, request.

But, as Rep. Mike Kelly, R-Pa., mentioned during the act's floor debate, "it shouldn't take a [FOIA] request to see what evidence the IRS is using against taxpayers."[27] And there is certainly no guarantee that larger taxpayers will receive a complete response to any FOIA request before an Appeals conference.[28]

Fourth, while the act limits the IRS' administrative-file disclosure obligation to "nonprivileged" material, it is silent on the recourse taxpayers should pursue — if any — if they feel the IRS has improperly claimed privilege over nonprivileged material. As noted above, clarity from Congress about remedies — if any — may help avoid unnecessary litigation in the future.

Conclusion

Section 1001 of the act is a laudable step in ensuring taxpayer access to the Appeals Office, which has long had a mission of critical importance to tax administration. But — perhaps because the provisions discussed herein were aimed at addressing a discrete scenario — Section 1001 raises issues and leaves gaps that Congress should consider before it becomes law.

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[1] Press Release, Lewis, Kelly Introduce Historic Bipartisan, Bicameral Legislation to Redesign the IRS, House Comm. on Ways & Means (Mar. 28, 2019).

[2] Section-by-section Summary of H.R. 1957, House Comm. on Ways & Means (Apr. 2, 2019).

[3] See S. 2809, 114th Cong. §§ 1-3 (2016); Protecting Taxpayers Act, S. 3278, 115th Cong. §§ 601-605 (2018).

[4] See Preserving Taxpayers' Rights Act, H.R. 3220, 115th Cong. §§ 2-4 (2017).

[5] Rev. Proc. 2016-22 at § 3.03, 2016-15 I.R.B. 577 (Mar. 23, 2016).

[6] ABA Tax Section Comments on Notice 2015-72 on Proposed Revenue Procedure on Administrative Appeals Process in Tax Court Cases, at § 4 (Nov. 17, 2015).

[7] Complaint, Facebook Inc. v. Internal Revenue Service, 17-CV-6490 (N.D. Cal. Nov. 8, 2017).

[8] Facebook Inc. v. Internal Revenue Service, 17-CV-6490, 2018 WL 2215743, *2 (N.D. Cal. May 14, 2018).

[9] National Taxpayer Advocate, 2019 Objectives Report to Congress at 136 (June 2018).

[10] Id. at 141.

[11] Press Release, Grassley, Wyden Introduce Taxpayer First Act to Modernize IRS, S. Fin. Comm. (Mar. 28, 2019). One reason is that similar legislation has been introduced in prior years and steadily gained support. 165 Cong. Rec. H3162 (daily ed. Apr. 9, 2019) (statement of Rep. Lewis) (noting that similar legislation had already passed the House three times).

[12] See, e.g., Satovsky v. Commissioner, 1 B.T.A. 22, 24 (1924); Block v. Commissioner, 2 T.C. 761, 762 (1943).

[13] National Taxpayer Advocate, 2019 Objectives Report to Congress at 136 (June 2018).

[14] Rev. Proc. 2016-22 at § 3.11, 2016-15 I.R.B. 577 (Mar. 23, 2016).

[15] See, e.g., I.R.C. Section 7461 (noting that, subject to certain exceptions, "all reports of the Tax Court and all evidence received by the Tax Court and its divisions, including a transcript of the stenographic report of the hearings, shall be public records open to the inspection of the public").

[16] Rev. Proc. 2016-22 at § 3.11, 2016-15 I.R.B. 577 (Mar. 23, 2016).

[17] See, e.g., Statement of Procedural Rules § 601.106(a)(1)(ii); Statement of Procedural Rules § 601.106(d)(2)(ii).

[18] Congress might have been concerned that establishing an Appeals right for taxpayers in a refund posture would impinge on section 7122(a), which provides that the Department of Justice "may compromise" refund litigations. Joint Committee on Taxation,Description of H.R. 1957, the "Taxpayer First Act of 2019"at 2 (JCX-15-19) (Apr. 1, 2019). But that is not true for taxpayers in a refund posture

who have not yet filed a refund suit and, in any event, Congress could coordinate new section 7803(e)(4) and section 7122(a).

[19] The description of the Act prepared by the Staff of the Joint Committee on Taxation does not elaborate on this issue but does note that, under the status quo, review by Appeals "is generally available prior to payment of any tax underlying the controversy." Joint Committee on Taxation,Description of H.R. 1957, the "Taxpayer First Act of 2019"at 2 (JCX-15-19) (Apr. 1, 2019).

[20] Another issue is that, because the Act's plain terms apply to "any taxpayer which is in receipt of a notice of deficiency," taxpayers might try to avail themselves of the protective measures even if they have already been to Appeals. In other words, taxpayers who were unable to resolve a dispute at Appeals and thereafter receive a notice of deficiency might seek a second bite at the apple. Congress could easily clarify whether it intends for the process contemplated in new section 7803(e)(5) to apply in such instances.

[21] Preserving Taxpayers' Rights Act, H.R. 3220, 115th Cong. §§ 2-4 (2017); Protecting Taxpayers Act, S. 3278, 115th Cong. §§ 601-605 (2018).

[22] To protect the IRS, Congress could provide an exception for instances where a taxpayer seeks Appeals review prior to the issuance of a notice of deficiency but refuses to extend the limitations period on assessment to allow for sufficient time for the Appeals process.Cf.Protecting Taxpayers Act, S. 3278, 115th Cong. § 603(b) (2018) (providing specific procedures in circumstances where "fewer than 60 days remain on [the] statute of limitations").

[23] Presumably, the IRS will create protest procedures using notice-and-comment rule making and take the position the rules have the force and effect of law. Cf.Policy Statement on the Tax Regulatory Process (Mar. 5, 2019), available at https://home.treasury.gov/system/files/131/Policy-Statement-on-the-Tax-Regulatory-Process-3-4-19.pdf ("The best practice for agency rule making is the notice-and-comment process established by the [APA].") But that is not a certainty and, even if it were, there is no guarantee that the IRS will properly apply or follow the procedures in every case.

[24] Naftel v. Commissioner, 85 T.C. 527, 529 (1985) ("It is well settled that the Tax Court is a court of limited jurisdiction, and [it] may exercise [its] jurisdiction only to the extent authorized by Congress.").

[25] Moya v. Commissioner, 152 T.C. No. 11 (2019).

[26] Section-by-section Summary of H.R. 1957, House Comm. on Ways & Means (Apr. 2, 2019).

[27] 165 Cong. Rec. H3163 (daily ed. Apr. 9, 2019) (statement of Rep. Kelly).

[28] This is especially true because FOIA requests are subject to agency "cut-off dates" rather than ongoing production requirements, see, e.g., Public Citizen v. Dep't of State, 276 F.3d 634 (D.C. Cir. 2002), which raises the specter that important material might be created after a taxpayer's FOIA request (but before any Appeals conference) and thus not be provided to a taxpayer under FOIA.