

Overview of ADR Options at the IRS

By Shannon Thomas*



I. INTRODUCTION

A. Overview

Alternative Dispute Resolution is a topic of discussion in almost every legal periodical and law school journal, and is mentioned at least once in a variety of law school courses. As a result of the increasing expense and time consumption of litigation, businesses and consumers are looking towards methods other than litigation to resolve conflicts. The federal government is no exception and is an example of a non-commercial organization finding a means of less costly and less time consuming forms of resolving disputes with taxpayers.

B. Congressional Background

In 1996, Congress found that administrative proceedings were increasingly costly, formal, and lengthy, and that alternative dispute resolution had worked in the private sector for many years, yielding faster, cheaper, and less contentious results.¹ Believing that alternative forms of dispute resolution would lead to more creative, efficient, and sensible outcomes, Congress sought to implement alternative forms of dispute resolution in federal agencies. As outlined in The Administrative Dispute Resolution Act of 1996, "alternative means of dispute resolution means any procedure that is used to resolve issues in controversy, including, but not limited to, conciliation, facilitation, mediation, fact finding, minitrials,

arbitration, and use of ombuds, or any combination thereof."² Congress rationalized that the use of well-tested dispute resolution techniques making alternative means of dispute resolution available would eliminate ambiguity, and enhance the operation of the government to better serve the public.³ When setting out to implement alternatives to litigation, Congress stressed that "each agency shall adopt a policy that addresses the use of alternative means of dispute resolution and case management."⁴ Similar to other entities, the IRS has implemented a number of alternative dispute resolution processes. The alternative dispute resolution methods implemented under the IRS program are in line with the Congressional goals of facilitating formal and informal adjudications and enforcement actions.

II. ADR PROGRAMS AT THE IRS

A. Overview

The Internal Revenue Service is organized around three high level organizations, 1) Commissioner, 2) Services & Enforcement, and 3) Operations Support.⁵ Reporting to the Commissioner are the IRS Chief Counsel, and the Appeals division, among other groups and reporting to the Services and Enforcement Division are four taxpayer divisions, 1) Small Business/Self Employed, 2) Wage and Investment, 3) Large and Mid-Size Business, 4) Tax Exempt and Government Entities, and the Criminal Investigation

Division.⁶ The divisional offices are responsible for returns classification, review, field examination, office examination and service.⁷ Audit and examination of returns originate in one of the four aforementioned taxpayer divisions, and unresolved issues are referred to the Appeals division.⁸

The alternative dispute resolution programs used by the IRS are flexible in that the parties can freely agree to participate in the programs which are deemed best for their situation. Like other forms of ADR, the IRS programs encourage cooperation among the parties, especially in mediation where the parties work with a neutral facilitator to reach a compromised settlement and a win-win outcome. On the other hand the parties work against each other in litigation and often view the process as a win-lose situation. The most common forms of ADR available at the IRS are Early Referral, Fast Track Mediation, Fast Track Settlement, Post Appeals Mediation and Arbitration.

B. Early Referral

Early Referral is a form of alternative dispute resolution used by the IRS to quickly resolve cases with the combined efforts of the District (examination or audit office) and Appeals.⁹ For example, if a taxpayer is being audited by the IRS and a disputed issue arises while the audit is being performed, the disputed issue can be subject to Early Referral. The purpose of Early Referral is to resolve certain issues while other issues are being examined. Early referral is used because the IRS believes that “early resolution of a key issue may encourage taxpayers and the service to agree on other issues in the case.”¹⁰ Issues that are appropriate for Early Referral are limited to the following:

- Issues that if resolved, can reasonably be expected to result in a quicker resolution of the entire case;
- Issues that both the taxpayer and the District agree should be referred to Appeals early;
- Issues that are fully developed; and
- Issues that are part of a case where the remaining issues are not expected to be completed before Appeals could resolve the early referral issue.¹¹

Some issues are excluded from Early Referral because they are counter-productive to the very nature of the “early” part of the program. For example, if a taxpayer is under audit and has a known issue for which he and the IRS examiner are in dispute, it would not be effective to send that issue to Early Referral if the examiner is likely to finalize the entire audit in a short period of time. Issues excluded from Early Referral are:

1. Issues with respect to which a 30-day letter has been issued;
2. Issues that are not fully developed;
3. Instances where the remaining issues in the case are expected to be completed before Appeals could resolve the early referral issue;
4. Issues that are designated for litigation by the Office of Chief Counsel;
5. Issues for which the taxpayer has filed a request for Competent Authority assistance or issues for which the taxpayer intends to seek Competent Authority assistance; or
6. Issues that would subject the government to conflicting claims of taxpayers.¹²

Early referral helps to resolve cases more quickly because Appeals and the examination office usually work simultaneously. Early referrals are initiated by the taxpayer in writing to the district office, and the district office must agree for the early referral

request to be approved. This seems somewhat unfair to taxpayers, as this procedure on its face grants unilateral power to the district office to grant or deny a request for early referral, leaving the taxpayer with limited options. If an agreement is reached, a closing statement will be prepared by Appeals. If Appeals does not agree with the taxpayer, Appeals will close the Early Referral file and return it back to the district office jurisdiction; Appeals will not reconsider an unagreed early referral issue if the case is later protested to Appeals. However, if there has been a substantial change in circumstances regarding the early referral issue, Appeals can reconsider the early referral issue. Although there is no formal appeal if an early referral request is denied, the taxpayer may request a conference with a supervisor of the examiner who denied the request for early referral, and the taxpayer is also free to pursue other methods of appeal.¹³

C. Fast Track Mediation

Fast Track Mediation is designed to help Small Business/Self Employed taxpayers.¹⁴ Fast Track Mediation involves either an Appeals officer or an Appeals team case leader who has been trained in mediation techniques. The Appeals personnel act as mediator between the taxpayer and the audit team, discussing

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issues between the taxpayer and the IRS, and possible ways of reaching a resolution. The IRS has a goal of reaching a joint resolution within forty days that is consistent with applicable tax law. Fast Track mediation is designed for taxpayers who would prefer to resolve their disputes in a shorter period of time. Reaching a compromised settlement in forty days would save the taxpayer time and money which would otherwise be spent on litigation. Additionally, because fast track mediation has a short time frame, taxpayers can quickly settle a dispute and move on to personal and business matters.

Fast Track Mediation is available for most issues that are not docketed in any court, such as disputes resulting from examination, offers in compromise, trust fund recovery penalties and other collection actions. Issues that are specifically excluded from mediation are issues with no legal precedent, issues where the courts’ decisions differ between jurisdictions, campus and automated collection system cases, and cases that involve frivolous arguments. Issues available under Fast Track Mediation tend to be those that are factual in nature.

To begin the Fast Track Mediation process, the taxpayer and IRS representative must sign an agreement to mediate, and all relevant decision-makers must be present. Because only an agreement to mediate is being signed initially, the taxpayer is not formally filing a written protest. The taxpayer may represent himself, or may officially appoint someone to act on his behalf. The IRS or the taxpayer may withdraw from the mediation at anytime, and the taxpayer will keep all his appeals rights for those issues that were not resolved in the mediation.

The goal of Fast Track Mediation is to resolve issues within an average of 30-40 days.¹⁵ This quick turnaround for resolving issues can be a selling point for the IRS. Another benefit of mediation is the confidential nature of the mediation session. Parties are often more likely to disclose pertinent information in a mediation session if they know the information cannot be used against them

adversely in a subsequent legal action. The confidential aspect of the program is an advantage to those individuals who prefer not to have their financial affairs made public. With Fast Track Mediation, the taxpayer retains legal appeals rights and thus, has very little to lose by mediating.

B. Fast Track Settlement

Fast Track Settlement is an ADR program for large and midsize business taxpayers.¹⁶ The purpose of the program is to help taxpayers resolve disputes during an audit examination while the case is still in the compliance area. Fast Track Settlement is also available for Small Businesses, Self Employed taxpayers and other taxpayers on a discretionary basis. The program is voluntary, and the resolution of the matter is not final unless the parties agree to a final resolution. Unlike Fast Track Mediation, Fast Track

the Appeals division, or the taxpayer can select his own mediator at his own expense.

Similar to other mediation situations, IRS mediators do not have the authority to order a settlement, but the parties may contractually agree to irrevocably resolve the dispute. With mediation as the chosen method of dispute resolution, the entire process can be completed within 90 to 120 days. If the mediator is selected from the Appeals office, the Appeals national office will assume all of the mediator's expenses. A taxpayer-selected mediator can come from any local or national organization that provides a list of neutral parties acting as mediators, and most mediation sessions are concluded in one day. If needed, however, the parties can schedule two additional mediation sessions.

Issues specifically excluded from Post Appeals Mediation are certain collection issues, issues that are not consistent with sound tax administration, frivolous arguments, and issues where the taxpayer did not act in good faith during the settlement negotiations.

Mediation can be requested on issues that are unresolved after the appeals procedure or after an unsuccessful attempt to enter into a closing agreement or compromise.

Settlement proceedings consider both legal and factual issues.

The taxpayer may request Fast Track Settlement after a "Notice of Proposed Adjustment" has been issued, and the taxpayer provides a written response. Fast Track Settlement involves an Appeals employee who assists the taxpayer and IRS representative in reaching a resolution of disputed issues. The specially trained Appeals officer brings Appeals resources to the audit site to resolve disputes before a 30-day letter is issued.

Dealing with the IRS over various issues can become expensive for business taxpayers due to the length of time it takes the IRS to process and review issues. Fast Track Settlement is a quick alternative of resolving disputes, allowing time for taxpayers to focus on their commercial operations. Benefits touted by the IRS for Fast Track Settlement are:

- A one page application;
- Consideration of the hazards of litigation;
- An answer within 120 days;
- No "hot" interest under Internal Revenue Code § 6621;
- Taxpayer may withdraw from the process at any time;
- Taxpayer retain all traditional appeal rights;
- Significantly shortens the taxpayer's IRS experience;
- Involves only one tax computation;
- The Taxpayer's case closes agreed in Compliance; and
- Immediate use of Delegation Order 236.¹⁷

Similar to Fast Track Mediation, Fast Track Settlement must be approved by the Appeals office. This is another example of the unilateral power of the Appeals office in resolving taxpayer issues through alternative forms of dispute resolution. If an agreement is not reached through Fast Track Settlement, the taxpayer retains his traditional his right to appeal.

C. Post Appeals Mediation

Post Appeals Mediation can be requested on issues that are unresolved after the appeals procedure or after an unsuccessful attempt to enter into a closing agreement or compromise. An additional requirement of mediation is that the taxpayer's case cannot be docketed in any court. Post Appeals Mediation with the IRS involves a mediator jointly selected by the taxpayer and the IRS to serve as a facilitator, helping the parties reach a negotiated settlement. Post Appeals Mediation should be limited to issues that are factual in nature, although certain legal issues may be handled under mediation. The mediators can come from

D. Arbitration

Binding Arbitration is another option available from the IRS, and may be requested for factual issues that are already in the Appeals administrative process, or after unsuccessful attempts to enter into a closing agreement under Internal Revenue Code § 7121.¹⁸ Arbitration is not available for cases that involve Compliance and Appeals coordinated issues, legal issues, certain collection issues, issues that are not consistent with sound tax administration, frivolous arguments and those where the taxpayer did not act in good faith during settlement negotiations.

The Arbitration program uses a neutral decision-maker who reaches a binding decision on issues that prevented the taxpayer and the Appeals division from reaching an agreement. Arbitration is a useful option in situations where an arbitrator's experience can be used to give the taxpayer a more favorable experience and outcome.¹⁹ The parties must agree to arbitration by filing a motion with the court before trial, and a provision must be attached with the issues to be resolved, and the parties' agreement to be bound by the arbitrator's decisions. Additionally, the document must contain the identity of the arbitrator, the arbitrator's compensation and how the parties will split the cost, as well as a prohibition against ex parte communication with the arbitrator.

The designation of an arbitrator may be conducted within the IRS or from an outside source. An IRS representative who serves as an arbitrator must be taken from another appeals region or serve at the national office. The motion for binding arbitration "may be made before trial at any time after the case is at issue."²⁰

Although arbitration is a more formal process than the other forms of alternative dispute resolution techniques, it does have advantages over litigation. Arbitration provides a relaxed set of rules of evidence and a relaxed adversarial setting, which may be beneficial to those taxpayers who lack representation or legal expertise.²¹ One benefit of arbitration is that The Administrative Dispute Resolution Act of 1996 allows for "arbitration on the condition that the award must be within a range of possible outcomes."²² Although this does not guarantee a definite outcome, it could induce a party to arbitrate knowing that the eventual outcome is one of several possible that had been previously discussed.

III. Conclusion

Congress has recognized a need to improve and expedite its the dispute resolution system. The IRS, under the direction of Congress, has implemented a number of programs for varying

taxpayers and issues. It is important for taxpayers to take advantage of the programs early in the dispute resolution process to prevent problems such as a lapse in the statute of limitations. Some of the advantages for using ADR at the IRS are:

- It provides a different avenue of resolving disputes when an agreement can not be reached between with the taxpayer and the examiner;
- The taxpayer becomes a person, not a number, because the meetings and proceedings are informal;
- Even in situations where the alternative dispute resolution mechanisms do not work for the parties, they have a relationship which may prove valuable in future proceedings;
- The proceedings offer confidentiality for those parties who prefer not to have a public trial or for their information to be made public.

While the ADR programs at the IRS have their advantages, they also have disadvantages. Some issues will not be resolved through mediation so that a precedent can be set. There are some instances when litigating a dispute in the court system would be quicker and cheaper than using ADR. Despite the possible disadvantages, however, the alternative dispute resolution programs at the IRS seem to be effective. According to the Office of the National Director of Appeals:

- 84% of respondents said they would use Appeals again;
- 70% were completely or somewhat satisfied with Appeals fairness and impartiality; and
- 70% were completely or somewhat satisfied with the overall Appeals process.²³

Based on these statistics, it seems as though alternative dispute resolution will continue to be a part of the Internal Revenue Service. It has gained acceptance in the early stages, and with time and improvement, it may eventually reduce or eliminate the need for litigation of tax issues.

For more information about ADR at the IRS, visit its website, www.irs.gov (keyword "appeals").

* Shannon Thomas is a third year law student at the University of Houston Law Center. She received her J.D. in May 2007.

1. The Administrative Dispute Resolution Act of 1996, Pub. L. No. 104-320, § 2.
2. 5 U.S.C.A. § 571 (1996).
3. The Administrative Dispute Resolution Act of 1996, Pub. L. No. 104-320, § 2.
4. *Id.* at § 3.
5. Saltzman, Michael, *IRS Practice and Procedure*, §8.02, 1999 WL 1050935, also available at <http://www.irs.gov/irs/article/0,,id=149197,00.html> (last accessed Apr. 18 2007).
6. *Id.*; see also <http://www.irs.gov/irs/article/0,,id=149199,00.html> (last accessed Apr. 18 2007).
7. *Id.*
8. *Id.*
9. Rev. Proc. 99-28, 1999-29 I.R.B. 109.
10. Internal Revenue Service, Department of Treasury, Publication 4167, *Appeals*, (2005).
11. *Id.*
12. *Id.*
13. *Id.*
14. Rev. Proc. 2003-41, 2003-25 I.R.B. 1047.
15. *Id.*
16. Rev. Proc. 2003-40, 2003-25 I.R.B. 1044.
17. *Id.*
18. Rev. Proc. 2006-44, 2006-44 I.R.B. 800.
19. John M. Beehler, *IRS Alternative Dispute Resolution Initiatives*, THE TAX ADVISOR (Feb. 2000).
20. *Id.*
21. Gregory P. Matthews, *Using Negotiation, Mediation, and Arbitration to Resolve IRS-Taxpayer Disputes*, 19 OHIO ST. J. ON DISP RESOL. 709, 722 (2004).
22. The Administrative Dispute Resolution Act of 1996, Pub. L. No. 104-320, 5 U.S.C. §575.
23. Thomas C. Louthan, *How to Handle a Tax controversy at the Restructured IRS and in Court*, SG063 A.L.I.-A.B.A. 245 (2002).