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Client Alert

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The IRS Proposes Revisions to the Appeals *Ex Parte* Guidelines — Is There Bite to the Bark?

On July 19, 2011, the IRS in Notice 2011-62[1] (the Notice) proposed for public comment updates to the Appeals *ex parte* guidelines contained in Rev. Proc. 2000-43.[2] The statutory mandate underlying the *ex parte* rule, which prohibits *ex parte* communications between IRS Appeals officers and IRS examiners and IRS Counsel involved with a protested audit adjustment, is to preserve the independence of the IRS Office of Appeals. Given the essential role that Appeals plays in resolving disputes between the IRS and taxpayers, as well as continuing concerns over the erosion of Appeals' independence, Notice 2011-62 has potential significance beyond the proposed technical revisions. Significantly, although Notice 2011-62 addresses some concerns previously raised with the existing *ex parte* guidelines, the proposed revisions appear to emphasize a view that the *ex parte* rule is more about form rather than a true prohibition on *ex parte* communications that "appear to compromise" Appeals' independence. Indeed, the IRS Notice emphasizes that a taxpayer has no redress for a violation of the *ex parte* rule.

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Background

Congress, in the IRS Restructuring and Reform Act of 1998, directed the IRS Commissioner to develop a plan, as part of the reorganization of the IRS, to

> ensure an independent appeals function within the [IRS], including the prohibition in the plan of *ex parte* communications between appeals officers and other [IRS] employees to the extent that such communications appear to compromise the independence of the appeals officers.[3]

The specificity of this directive was purposeful. Appeals is charged with resolving 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."[4] Congress understood that taxpayers would question whether they were getting a fair and impartial administrative hearing before Appeals if IRS examiners (and the IRS counsel who were advising them) were allowed to have *ex parte* communications with Appeals officers and provide information or comments not contained in the examination file. Thus, Congress prohibited not only *ex parte* communications that, in fact, compromised Appeals' independence, but also *ex parte* communications that *would appear* to do so.

The current *ex parte* guidelines are contained in Rev. Proc. 2000-43, which finalized rules first proposed in Notice 99-50.[5] The proposed revisions in Notice 2011-62, apart from converting the guidelines into narrative format from question-and-answer (Q&A) format, generally incorporate much of the existing guidelines. Certain changes, however, appear intended to minimize (some might argue, eliminate) the impact of the *ex parte* rule on IRS operations, and taken as a whole, it is difficult to view the proposed revisions as strengthening the *ex parte* rule or reinforcing the independence of Appeals.

"Self-Enforcement"

The Notice continues the much-criticized IRS practice of having Appeals self-enforce the proscription against *ex parte* contacts. That is, there are no procedures established by which a taxpayer can inquire or test whether an improper *ex parte* communication has occurred, nor are any remedies established for violations. Rather, the Notice provides that "most breaches of the *ex parte* communication rules may be cured by timely notifying the taxpayer/representative of the situation" and affording "a reasonable period of time within which to respond." Any further remedy is left to the sole discretion of Appeals. Given that the courts have repeatedly rebuked the IRS for failing to monitor and inform taxpayers of breaches in the relatively few instances where such prohibited communications have occurred in the context of a case that proceeds to litigation,[6] and that the National Taxpayer Advocate (NTA) in her 2010 Annual Report to Congress[7] identified the failure of Appeals to adequately document such breaches as one of the "Most Serious Problems" of the IRS (discussed below), the failure of the Notice to provide any procedure or specific remedy is remarkable.

The Notice's failure to provide for transparency of the details of potential or admitted breaches of the *ex parte* rules, or to provide for any remedy for taxpayers to assert, remains inconsistent with the practices of other federal agencies.[8] And, so long as the IRS' interpretation of what constitutes an improper *ex parte* communication differs from those of the courts (and of the National Taxpayer Advocate), the IRS' decision to "self-enforce" these fundamental rules of due process and fair play suggests that taxpayers should continue to be vigilant in inquiring as to potential prohibited communications and in requesting to participate in all communications of which they are given advance notice.

Loosening the Restrictions on IRS Chief Counsel

One of the less taxpayer-favorable proposed changes is the revision to the guidelines governing Appeals interaction with IRS Chief Counsel. Although no one would argue that Appeals should not have access to legal advice, Rev. Proc. 2000-43 contained several important limitations on interaction with Counsel attorneys that might compromise Appeals' independence. The most important limitations relate to proscriptions against (i) *ex parte* communications with Counsel field attorneys who advised the originating IRS function (*e.g.*, Exam) and (ii) recommendations of settlement ranges by Counsel attorneys.

IRS Chief Counsel Field Attorneys Who Advised the Originating IRS Function

Existing Q&A 11 of the Rev. Proc. 2000-43, addressing Appeals' interactions with Counsel field attorneys, sets out a bright-line standard and is worth quoting in full:

> Appeals employees should not communicate *ex parte* regarding an

> issue in a case pending before them with Counsel field attorneys who have previously provided advice on that issue in the case to the IRS employees who made the determination Appeals is reviewing. *Counsel will assign a different attorney to provide assistance to Appeals*. If an Appeals employee believes it is necessary to seek advice from any Counsel field attorney who previously provided advice to the originating function regarding that issue in the case, the taxpayer/representative will be provided an opportunity to participate in any such communications.[9]

For unexplained reasons, the proposed revisions to these guidelines in Notice 2011-62 have been significantly weakened. Now, the Counsel field attorney advising the originating IRS function must have "personally" advised or advocated on the issue, and whether they did so is now dependent on an internal assessment (one not likely to be shared with the taxpayer) of the "extent and nature of the field attorney's involvement." Further, the field attorney must have rendered advice with not only respect to the same issue but also in the "same case." It is not clear how this rule will apply to field attorneys in situations where the same issue is presented in multiple cases, as is typical for large corporate taxpayers. More importantly, the revised guidelines eliminate the current requirement that a different Counsel field attorney be assigned when that attorney had previously advised the IRS employee whose determination is being reviewed by Appeals.

In sum, Notice 2011-62 has shifted the ground from a bright line rule that reflected concern with the *appearance* of Appeals' independence to a murky substitute that will allow Appeals and Counsel to contend that the field attorney did not actually impair Appeals' independence by reason of his or her involvement with the originating function. This is a substantial step backward for taxpayers. Taxpayers and their advisors, more than ever, need to be on high alert for the involvement of Counsel field attorneys who advised the originating IRS function. If the proposed revisions are finalized, taxpayers must be prepared, if they detect the presence of Counsel field attorneys in the Appeals process, to ask about the precise nature of the attorney's involvement with the originating IRS function.

IRS Chief Counsel Recommendations of Settlement Ranges

Q&A 11 also contains a hard and fast rule that "Counsel attorneys will not provide advice that includes recommendations of settlement ranges for an issue in a case pending before Appeals or for the case as a whole." This proscription has been eliminated in favor of the watery language in the revised guidelines that cautions that Appeals officers are responsible for independently evaluating the strengths and weaknesses of the specific issues in the case and need not follow Counsel's advice. Thus, it would appear that Counsel attorneys now have the ability to intrude themselves into this core Appeals function without limitation.

Other Significant Aspects of the Proposed Revisions

In addition to promulgating several "guiding principles" to aid in the overall understanding of the *ex parte* restrictions, Notice 2011-62 contains several proposed revisions to guidelines for the *ex parte* rule worth noting:

- Additional categories of communications that are not restricted by the *ex parte* rule (*e.g.*, alternative dispute resolution cases, post appeals mediations, Appeals' communications with the Department of Justice, Appeals communications with the Criminal Investigations division, communications related to certain

types of closed cases, communications related to general case information such as the number and type of similar open cases, etc.)
- Clarification of the rules governing the types of communications that may be included with the transfer of the administrative file by the originating IRS function to Appeals (intended, apparently, to eliminate the practice of including prohibited *ex parte* communications in the transmittal memorandum, or T-letter, from IRS Exam to Appeals)
- Rules governing Appeals' and the IRS originating functions' communications when a taxpayer claims a refund while a case is under Appeals' jurisdiction, where multiple cases are open and when a settlement initiative is applicable to a case

Continuing Differences Over the Size of Any Problem

In her 2010 Annual Report to Congress, the NTA identified concerns with the administration of the *ex parte* rule as Number 8 of her Most Serious Problems Encountered by Taxpayers.[10] The NTA's report on this issue, and the response by Appeals to the NTA's recommendations, reflect a disagreement over whether there is even a significant problem with the IRS' administration of the *ex parte* rule.

The NTA made seven recommendations to the IRS that can be divided, roughly, into four categories: (i) develop a system to document and evaluate *ex parte* violations, with the ultimate goal of using that information to reduce future *ex parte* violations; (ii) better understand the impact of *ex parte* violations on taxpayer perceptions of Appeals' independence and taxpayer willingness to utilize the Appeals process; (iii) elevate the *ex parte* guidelines to a Treasury Regulation; and (iv) improve *ex parte* rule compliance through training initiatives. As to the form of *ex parte* rule guidance, the IRS obviously is proceeding as it has done before, with a notice requesting comments to a proposed revenue ruling, followed by a revenue ruling containing final guidance. Issuing *ex parte* rule guidance in the form of Treasury Regulations would require consideration of public comments and some description of how they were addressed, and it would make it more difficult, at least in theory, for the IRS to depart from its own guidance. In light of the IRS' position on the consequences of an *ex parte* violation — none — it is highly unlikely that the IRS will change its proposed vehicle for *ex parte* rule guidance.

The other three recommendations revolve around differing perceptions of the extent, or potential extent, of the problem of *ex parte* violations and its consequences. The NTA is seeking to have the IRS better understand the extent of the problem and its impact on taxpayer confidence in Appeals, and to have the IRS work to minimize *ex parte* violations through additional training. The IRS Office of Appeals, in its response, states that the tracking of *ex parte* violations is adequate (and has identified no violations since 2007), that taxpayer satisfaction with Appeals and its independence is high and that existing training is extensive and effective. Given this significant difference of opinion, it is difficult to see the IRS significantly altering its administration of the *ex parte* rule to be more responsive to the concerns expressed by the NTA, which echo the concerns expressed by many taxpayers and practitioners.

Where Does Tax Administration Go From Here?

Congress has spoken in mandating an *ex parte* prohibition, the courts have rebuked the IRS when it has either ignored such violations or interpreted its rules narrowly to try to escape the prohibition, and the National Taxpayer

Advocate has criticized the IRS for not taking action to ensure that the *ex parte* rules are precise, enforceable (in regulations), monitored and documented as to nature and quantity, and properly instructed to all elements of the IRS that could potentially violate them. Nonetheless, Notice 2011-62 proposes a new revenue procedure (not regulations), weakens the original rules governing communications with IRS Counsel, provides no transparency, procedural inquiry rights or specific remedies to taxpayers, and establishes no system for tracking violations as a means to reduce future violations. It remains to be seen whether this further erosion of the independence, and certainly of the appearance of independence, of the IRS Office of Appeals will affect the heretofore well-deserved reputation and enviable record of successful resolutions that Appeals has historically maintained.

Endnotes

[1] 2011 I.R.B. LEXIS 408.

[2] 2000-43 I.R.B 404.

[3] Pub. L. No. 105-206, 112 Stat. 685, §1001(a)(4).

[4] Internal Revenue Manual § 8.1.1.1(1) (2007).

[5] 1999-40 I.R.B. 444.

[6] *See, e.g., Robert v. United States*, 364 F.3d 988 (8th Cir. 2004); *Planes v. United States*, 98 AFTR2d (RIA) 7044 (M.D. Fla. 2006); *Lewis v. Commissioner*, 128 T.C. 48 (2007); *Drake v. Commissioner*, 125 T.C. 201 (2005); *Industrial Investors v. Commissioner*, T.C. Memo 2007-93; *Moore v. Commissioner*, T.C. Memo 2006-171; *Sapp v. Commissioner*, T.C. Memo 2006-104; *Harrell v. Commissioner*, T.C. Memo 2003-271.

[7] Taxpayer Advocate Service, 2010 Annual Report to Congress, vol. 1 at 110-127.

[8] *See* Kafka, Cavanagh, and Akins, "Do IRS Appeals' Office Ex parte Prohibitions Need Strengthening?," 122 Tax Notes 1591 at 1598-1600 (March 30, 2009).

[9] 2000-43 I.R.B. 404 (emphasis added).

[10] Taxpayer Advocate Service, 2010 Annual Report to Congress, vol. 1 at 110-127.

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