taxanalysts special report

SETTLING WITH THE IRS: THE IMPORTANCE OF PROCEDURE

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In this report, the author explores fundamental procedures and related principles and concepts that contribute significantly to the shaping of the settlement process in federal tax controversies. Stein believes that an understanding of the procedural nuances of settlement practice in tax cases is vital as enforcement reemerges as a top IRS priority.

This article does not constitute tax, legal, or other advice from Deloitte Tax LLP, which assumes no responsibility with respect to assessing or advising the reader as to tax, legal, or other consequences arising from the reader's particular situation. The author expresses his thanks to Thomas Cryan and John Keenan of Deloitte Tax LLP for their assistance in reviewing this article.

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The Internal Revenue Service Restructuring and Reform Act of 1998 compelled the IRS to concentrate its limited resources on taxpayer service activities. Enforcement declined.[1] Now, with congressional anxiety over tax shelters (evidenced by, among other things, the enactment of sweeping tax shelter penalties in late 2004[2] and continuing investigations);[3] a daunting tax gap;[4] adverse publicity about marginal audit coverage;[5] and record-high U.S. deficits, enforcement has reemerged as a significant administrative priority.[6] According to recent IRS

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[1]The Government Accountability Office recently observed:

> In recent years, the resources IRS has been able to dedicate to enforcing the tax laws have declined, while IRS's enforcement workload — measured by the number of taxpayer returns filed — has continually increased. Accordingly, nearly every indicator of IRS's coverage of its enforcement workload has declined in recent years. Although in some cases workload coverage has increased, overall IRS's coverage of known workload is considerably lower than it was just a few years ago.

Government Accountability Office, *High Risk Series: An Update*, GAO-05-207 (January 2005).

[2]New section 6707A imposes a penalty ranging from $50,000 to $200,000 for failing to disclose a reportable transaction as defined in reg. section 1.6011-4. Assertion of the penalty is not subject to judicial review. New section 6662A imposes a penalty of up to 30 percent on an understatement of tax (determined without regard to whether the taxpayer is in a net operating loss or capital loss position) attributable to listed and reportable avoidance transactions.

[3]*See* Permanent Subcommittee on Investigation of the Committee on Homeland Security and Government Affairs, *The Role of Professional Firms in the U.S. Tax Shelter Industry* (Feb. 8, 2005).

[4]The IRS recently suggested a tax gap of as much as $300 billion a year, based on 2001 statistical data. *See* IRS Fact Sheet FS-2005-14 (Mar. 29, 2005).

[5]''IRS Audit Rate Down, Data Show,'' *Chicago Tribune*, Apr. 12, 2004, at 17; David Cay Johnston, ''Corporate Risk of a Tax Audit Is Still Shrinking, I.R.S. Data Show,'' *The New York Times*, Apr. 12, 2004, at C5.

[6]*See, e.g.*, ''Enforcement Remains Priority for LMSB, Nolan Says,'' *Doc 2004-20442, 2004 TNT 202-2* (Oct. 19, 2004); *Written Statement of Commissioner of Internal Revenue Mark W. Everson Before the Senate Committee on Appropriations Subcommittee on Transportation, Treasury, and General Government Hearing on Internal Revenue FY 2005 Budget Request* (Apr. 7, 2004) (stating that ''we must restore the balance between service and enforcement''); ''IRS Officials Echo Everson: Quicken Audit Cycle, Push Enforcement,'' *Doc 2003-23820, 2003 TNT 213-2* (Nov. 4, 2003); Prepared Testimony of Commissioner Mark W. Everson Before the Senate Finance Committee Hearing on Corporate Tax Shelters (Oct. 21, 2003) (stating that ''the IRS must allocate additional resources to enforcement''); *see generally* ''IRS Strategic Plan, 2005-2009'' at 18-25 (emphasizing need for improved enforcement).

statistics, examination activity is moderately accelerating.[7] An increasingly aggressive governmental approach to enforcement and a concomitant escalation in tax controversies can be anticipated, demanding well-honed practitioner dispute resolution skills.

This report focuses on the procedural aspects of settlement, a critical component of the tax controversy scheme given that upward of 95 percent of all examined cases[8] are disposed of by settlement,[9] either at the administrative level or in the course of litigation. That impressive figure reflects the fact that, contrasted to trial and adjudication, settlement offers significant advantages to taxpayers and the government alike.[10]

From the procedural perspective, however, the process must be approached with the utmost care. Official representational responsibilities within the executive branch regarding the administration of internal revenue disputes; the allocation of and limitations on institutional settlement authority; the forms and significance of administrative and legal settlement documentation; and the legal effect (for example, interpretation, enforceability, and finality) of a settlement — as dictated by statutes, regulations, case law, and even judicial rules and procedures — all vary with the stage, nature, and venue of the dispute. In other words, effective settlement planning in tax controversies is replete with procedural concerns. For the unwary, the potential pitfalls are many.

The discussion that follows explores a variety of fundamental procedures and related principles and concepts that contribute significantly to the shaping of the settlement process in federal tax controversies, both at the administrative level and in the docketed (litigation) setting.[11] The discussion concludes with some practical and strategic observations on dispute-resolution decisionmaking.

I. Administrative Settlements

A. Examinations

1. Settlement authority. Exam's[12] primary responsibility is to determine the relevant facts of the case and apply the law, as interpreted by the commissioner, to those facts. In the examination setting, the revenue agent[13] ordinarily functions as the ''line'' representative for the IRS. The delimited, fact-finding role of the agent represents a practical limitation on his authority to resolve issues. Although, in practice, the agent may choose to forego potential issues in recognition of concessions by the taxpayer, he is prohibited from taking into account the hazards of litigation for any particular issue or issues.[14] As discussed later, that prerogative rests with the IRS Appeals Division (IRS Appeals or Appeals) and the IRS Chief Counsel's Office (IRS counsel or counsel).

The agent's determination is subject to supervisory review and may be subject to quality review. Either review function may necessitate reconsideration of an issue by the agent. A case involving a refund (inclusive of deficiency interest) exceeding $2 million is required by law to be reported to the Joint Committee on Taxation.[15] Any exception taken by JCT refund counsel can similarly lead to the reevaluation of a determination.[16] And IRS Appeals also may return the case for further issue development and consideration.[17]

A variety of additional restrictions circumscribe the authority of the agent (such as it is) to dispose of issues. Most notably, the agent:

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[7]''IRS Releases 2004 Enforcement Data, Touts Record Revenues,'' *Doc 2004-22162, 2004 TNT 224-12* (Nov. 18, 2004).

[8]Controversies can, of course, emerge not only out of the examination process, but also in the prefiling and collection settings as well. A discussion of dispute resolution and minimization procedures and techniques in those arenas is beyond the scope of this report.

[9]For purposes of this article, ''settlement'' is used broadly to refer to any agreed resolution, regardless of form, mutuality, finality, or conclusiveness.

[10]Among the more notable, it can (1) bring quicker closure and certainty; (2) save significant time and conserve resources; (3) allow flexible and collaborative solutions that are beyond the reach of trial and adjudication; (4) enable the parties to preserve a cooperative relationship; (5) avoid publicity (at least if the settlement occurs before the commencement of litigation); (6) permit sensitive information to be kept confidential; and (7) help avoid the creation of unfavorable precedent. That is not to imply, of course, that every tax dispute can be settled, or that settlement necessarily assures the optimal result in every case. A host of factors and intangibles (to say nothing of the predisposition of the other party) must be considered in determining the optimal modality and forum for resolution.

[11]Irrespective of whether a tax practitioner is authorized to practice in the courtroom, it is imperative that he have an understanding of the controversy process in its entirety, so that the client may be properly advised of all available procedural avenues in a current dispute or of the implications and effect of a settlement previously entered into.

(Footnote continued in next column.)

[12]''Exam'' as used here refers to the examination function within the compliance organizations of the four IRS operating divisions: Large and Midsize Business (LMSB), Small Business/Self-Employed (SB/SE), Wage and Investment, and Tax Exempt/Government Entities.

[13]Depending on the size, nature, and complexity of the case, the type of taxpayer, and the location of the examination, the examining official may be alternatively titled ''examiner'' or ''office auditor.'' For the sake of convenience, the term ''agent'' is used hereinafter to refer to any examining line official.

[14]*See* IRM 4.10.7.5.3.1 (''Examination personnel have the authority and responsibility to reach a definite conclusion based on a balanced and impartial evaluation of all the evidence. . . . This authority does not extend to consideration of the hazards of litigation). It should be noted, however, that at the supervisory level, LMSB team managers have discretion to approve the application of an IRS Appeals hazards settlement with respect to a coordinated industry case (that is, a large case) taxpayer to a prior or subsequent examination year of the taxpayer if certain requirements are satisfied. *See* C.D.O. 4-24 and the discussion below at section I.F.1. The settlement may be memorialized via either Form 870-AD (discussed in section I.B.2. below) or a closing agreement (discussed in section I.C.). Also, both LMSB team managers and SB/SE group managers may adopt a hazards settlement proposed by an Appeals officer/mediator in a case made subject to the IRS's fast-track settlement procedures, discussed below in section I.F.3. The settlement may be documented in a similar fashion.

[15]*See* section 6405(a).

[16]IRM 4.36.1.2.5.

[17]IRM 8.2.1.2.

- must respect an IRS-favorable technical advice memorandum or technical expedited advice memorandum (TEAM) issued in the case;[18]
- may not deviate from a national settlement initiative;
- may not resolve an issue that has been nationally suspensed, pending a judicial determination;
- may not resolve a coordinated issue[19] in a manner contrary to the coordinated position[20]; and
- has limited discretion to resolve accounting method issues. Specifically, if the agent determines that the taxpayer is using an impermissible accounting method or changed its accounting method without the IRS's consent, the agent must change the method to a proper method. Also, the agent generally must make the change in the earliest tax year under examination (or, if later, the first tax year the taxpayer's method is considered impermissible) and impose a section 481(a) adjustment in the year of change. The agent may not consider hazards of litigation in determining either the year of change or the amount of the section 481(a) adjustment.[21]

2. Settlement documentation. At the conclusion of the examination, if adjustments are proposed, the taxpayer ordinarily is afforded the opportunity to discuss and, if he chooses, agree, in whole or part, to the agent's determination.[22] The agent may use any one of a variety of forms to document taxpayer assent, depending on the nature of the dispute. Basic forms[23] include:

- Form 870, ''Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment'';[24]

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[18]*See* reg. section 601.105(b)(5)(vii). As a dispute resolution tool, the TAM/TEAM process is a two-edged sword. Taxpayer-favorable advice ordinarily will end the dispute at the examination level. *See* Rev. Proc. 2005-2; 2005-1 IRB 86, *Doc 2005-235, 2005 TNT 12-9*. (For special rules regarding the issuance of TAMs/TEAMs in cases involving tax-exempt and governmental entities, see Rev. Proc. 2005-5, 2005-1 IRB 170, *Doc 2005-238, 2005 TNT 2-12*.) On the other hand, IRS-favorable advice will, as indicated above, bind Exam (except in narrow circumstances with respect to coordinated industry cases). Moreover, while IRS-favorable advice will not prevent IRS Appeals from disposing of an issue in accordance with its existing authority, that advice may, as a practical matter, portend the inevitability of litigation.

[19]Having long recognized that the uniform and consistent treatment of similarly situated taxpayers is an indispensable element of sound tax administration, the IRS maintains a variety of programs dedicated to that goal with respect to the disposition of recurring, significant issues in examination and administrative appeal cases. Significant among those programs are the Compliance function's Technical Advisor Program, the Appeals Industry Specialization Program (ISP), and the Appeals Coordinated Issue (ACI) Program. The Technical Advisor Program identifies and develops emerging industrywide and cross-industry issues. Technical advisers serve as national experts in a particular industry or issue area and are responsible for proposing and monitoring coordinated issues. The Appeals ISP serves a complementary role. Appeals ISP coordinators with industry or specialty-area expertise work with Compliance industry specialists and IRS counsel to develop coordinated issues. They also formulate and disseminate settlement guidelines on those issues. The focus of the ACI program is somewhat broader than that of Appeals ISP. Specifically, the ACI Program identifies and develops issues that (1) are common to industry, occupational groups, a large number of partners, shareholders, or creditors; or (2) involve a nationwide tax avoidance scheme or noncompliance transaction. Issues can be legal or factual and are coordinated at the national level. ACI coordinators are Appeals personnel who have expertise on an issue or category of case. Similar to Appeals ISP coordinators, ACI coordinators formulate settlement positions on coordinated issues.

In addition to the foregoing programs, the IRS also carries on an Industry Issue Resolution Program (IIRP), which permits business taxpayers, industry associations, and other interested parties to propose issues for IRS prefiling guidance. To be eligible for the IIRP, an issue must have two or more of the following characteristics:

1. The proper tax treatment of a common factual situation is uncertain.
2. The uncertainty results in frequent, and often repetitive, examinations of the same issue.
3. The uncertainty results in taxpayer burden.
4. The issue is significant and impacts a large number of taxpayers, either within an industry or across industry lines.

(Footnote continued in next column.)

5. 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.

See Rev. Proc. 2003-36, 2003-1 C.B. 859.

[20]*See* IRM 4.40.1.1.1.7. In general, any settlement of a coordinated issue requires prior review and approval by the designated coordinator. *See* C.D.O. 4-25. With appropriate clearance, LMSB team managers and SB/SE territory managers may accept settlement offers and execute Form 906 closing agreements, Forms 870, and so forth to effectuate the settlement of a coordinated issue. *Id.* below.

[21]Rev. Proc. 2002-18, 2002-1 C.B. 678, *Doc 2002-6515, 2002 TNT 51-8*.

[22]Reg. section 601.105(b). If agreement is not reached, the taxpayer normally has the opportunity to commence an administrative appeal by filing a protest. Alternatively, as discussed later, he may have the option of requesting the application of fast-track procedures.

[23]Additional forms, regarding passthrough entity examinations, are discussed in section I.D.

[24]Form 870 generally is used for partially agreed individual and corporate income tax cases; unagreed income tax cases requiring a 30-day letter; JCT cases; and certain other situations. Form 4549 is generally used for regular, fully agreed income tax cases (however, Form 1902-B or 4549OA-CG may be used for fully agreed individual income tax cases subject to office audit).

It is noteworthy that, in general, an executed 870-series or 890-series form (including the versions of those forms used by IRS Appeals; see section I.B.2.) can serve as a claim for refund of any overpayment attributable to the agreed overassessment. Rev. Proc. 68-65, 1968-1 C.B. 555. It would appear, however, that this is not true with respect to TEFRA partnership cases, discussed in section I.D below. Under TEFRA, the filing of a separate claim by the taxpayer may be necessary to properly apply a settlement relating to partnership items to him, even though the taxpayer has already signed an 870-series form.

- Form 870-E, ''Waiver of Restrictions and Collection of Deficiency and Acceptance of Overassessment (Exempt Organizations)'';
- Form 890, ''Waiver of Restrictions on Assessment and Collection of Deficiency and Acceptance of Overassessment — Estate, Gift, and Generation-Skipping Taxes'';
- Form 1902-B, ''Report of Individual Income Tax Examination Changes'';
- Form 2297, ''Waiver of Statutory Notification of Claim Disallowance'';
- Form 2504, ''Agreement to Additional Assessment and Collection of Tax and Acceptance of Overassessment (Excise or Employment Tax)'';
- Form 3363, ''Acceptance of Proposed Disallowance of Claim for Refund or Credit'';
- Form 4549, ''Income Tax Changes''; and
- Form 4605, ''Income Tax Changes — Partnerships, Fiduciaries, S Corporations, and Interest Charge Domestic International Sales Corp.''[25]

3. Effect of settlement. Resolution of the case by agreement often brings closure as a practical matter. It is the IRS's policy not to reopen (for the purpose of making an unfavorable adjustment against the taxpayer) an examined case that has been closed as agreed unless (1) there is evidence of fraud, malfeasance, collusion, concealment, or misrepresentation of a material fact; (2) the closed case involved a clearly defined substantial error based on an established IRS position existing at the time of the previous examination; or (3) other circumstances exist indicating that the failure to reopen would be a serious administrative omission.[26] Reinspection of the return is also impeded by statute.[27]

It must be emphasized, however, that the taxpayer's consent to assessment of additional tax is generally without binding effect on the IRS, so far as the determination of the correct amount of tax liability for the year is concerned.[28] That is true even though the IRS may purport to ''accept'' the determination.[29] The taxpayer's consent has been held to constitute a waiver (for example, a waiver of the right to receive a notice of deficiency).[30] Thus, the taxpayer's agreement to assessment of an examination deficiency does not preclude the IRS from subsequently determining that a greater amount of tax is due, provided that there has been no intervening adjudication of the taxpayer's liability for the year and the period of limitations on assessment remains open.[31] Nor is the IRS's policy against reopening closed cases a defense. The policy, it has been held, is directory rather than mandatory.[32] Consequently, it may not be relied on by the taxpayer as a bar to further assessment.[33]

In a similar vein, the agent's determination of an overassessment that gives rise to an overpayment does not automatically confer on the taxpayer a right to a refund.[34] Moreover, even if the refund is made, the IRS is

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[25]Form 4605 is used to secure full agreement to passthrough adjustments at the entity level. Form 875, ''Acceptance of Examiner's Findings by a Partnership, Fiduciary, S Corporation, or Interest Charge Domestic International Sales Corp.,'' may be used to secure partial agreement. Execution of either form for the entity, however, generally is without binding effect on the individual partners, shareholders, members, beneficiaries, and so forth. In the non-TEFRA partnership setting (*see* section I.D. below for a discussion of the TEFRA partnership rules), those taxpayers may signify full agreement to assessment of any additional tax on Form 4549. In the TEFRA partnership setting, 870-series forms are used to document consent to adjustments and to the assessment of additional tax, and other items, at the partner/member level.

[26]Rev. Proc. 2005-32, IRB 2005-23, *Doc 2005-11248, 2005 TNT 98-42*; *see also* IRS Policy Statement P-8-49 (providing that an agreed examination issue should not be reopened by IRS Appeals). For purposes of Rev. Proc. 2005-32, an agreed case is deemed closed after examination when the IRS notifies the taxpayer in writing after a conference, if any, of adjustments to the taxpayer's liability or acceptance of the taxpayer's tax return or exempt status without change. A case involving a refund or credit that is subject to JCT review is not considered closed until JCT review procedures and any necessary follow-up are completed. Also, when the taxpayer and the IRS have agreed to enter into a closing agreement, the case is not closed until the closing agreement is signed by the appropriate IRS official. In the case of an entity examination subject to TEFRA partnership procedures, the case is not considered closed or agreed unless all partners have signed settlement agreements or a no-change letter has been issued to the tax matters partner (TMP).

(Footnote continued in next column.)

[27]*See* section 7605(b) (providing that, as a general rule, the IRS may inspect taxpayer's books only once for each tax year). For an in-depth discussion of the application and limitations on the reach, of this statute, see Ronald A. Stein, ''Are IRS Compliance Checks Examinations?'' Tax Notes, Mar. 25, 1996, p. 1819.

[28]*Joyce v. Gentsch*, 141 F.2d 891 (6th Cir. 1944); *Findlay v. Commissioner*, 39 T.C. 580 (1962); *Auerbach Shoe Co. v. Commissioner*, 21 T.C. 191 (1953), *aff'd* 216 F.2d 693 (1st Cir. 1954). Note, however, that special rules apply with respect to certain administrative determinations on partnership items, which, by agreement of the parties, may be binding on both sides. *See* section 1.D. below.

[29]*Hudock v. Commissioner*, 65 T.C. 351 (1975).

[30]*Payson v. Commissioner*, 166 F.2d 1008 (2d Cir. 1948); *Holland v. Commissioner*, 70 T.C. 1046 (1978); *see* reg. section 301.6213-1(d). Even if the consent amounted to something more, an agent, in general, is without authority to bind the IRS to a final settlement of the taxpayer's liability.

[31]Reg. section 601.105(b)(4).

[32]*Estate of Meyer v. Commissioner*, 58 T.C. 311 (1972), *aff'd per curiam* 503 F.2d 556 (9th Cir. 1974).

[33]*See Miller v. Commissioner,* T.C. Memo. 2001-55, *Doc 2001-6608, 2001 TNT 45-14*, and the cases there cited.

[34]*See, e.g., Sara Lee, Corp. v. United States*, *Doc 93-9941, 93 TNT 196-20*, 29 F.Cl. 330 (1993) (determination of overassessment in examination report was not entitled to presumption of correctness so as to shift the burden of proof to the government in refund suit; held: report does not constitute final governmental action and therefore creates no presumption in the taxpayer's favor).

not foreclosed from seeking its recovery on the ground it was made in error.[35]

What holds true for the IRS largely also holds true for the taxpayer. That is, his consent to assessment, and the payment, of additional tax determined on examination ordinarily does not prevent the subsequent filing of a refund claim to recover the payment, even if the period of limitations on assessment has closed, so long as the period of limitations on refund is open.[36] Likewise, the taxpayer does not forfeit the right to file a refund suit simply by reason of consenting to the disallowance of a refund claim.

In summary, the typical Exam settlement, while often viewed by the parties as a settlement in fact for all practical purposes, is not legally conclusive of the taxpayer's tax liability for the year any earlier than on expiration of both the assessment and refund limitations periods.[37] An important corollary is that, in the absence of a closing agreement (discussed in section I.C. below), a return position accepted on examination does not, per se, bind the IRS for subsequent years.[38] Thus, the allowance of a deduction or the allowance of an exclusion from income for an item of a recurring nature does not prevent the IRS from disallowing a similar deduction, or requiring the inclusion of a similar item, on a subsequent return.[39] By the same token, generally speaking, the taxpayer's acceptance of the disallowance or the inclusion of an item does not, without more, constitute a validation of the IRS position, nor a commitment by the taxpayer to adhere to that position on subsequent returns.

B. Appeals

1. Settlement authority. The historical mission of IRS Appeals is to settle tax disputes. Appeals' subject-matter jurisdiction is expansive, and includes disputes over:[40]

- proposed assessment, or disallowance of claims for refund, of income, estate, gift, employment, and excise taxes, plus additions to tax, additional amounts, and penalties;
- collection due process;
- offers in compromise;
- assessable penalties;
- abatement of interest; and
- jeopardy levies.

The bulk of Appeals' substantive (noncollection) workload flows directly from Exam in the form of protested cases. Appeals has exclusive settlement jurisdiction over those cases while they remain under consideration by Appeals personnel.[41] Also, deficiency cases petitioned by taxpayers to the Tax Court directly from Exam (docketed cases) are ordinarily referred to Appeals by IRS counsel.[42] Appeals has exclusive settlement jurisdiction over those cases as well, until they are noticed for trial or, if earlier, settlement negotiations conclude without success.[43]

In the administrative appeal milieu, the Appeals officer (or Appeals team case leader in a coordinated industry case) assumes the mantle of official representational responsibility.[44] His task is to negotiate the settlement of cases on a basis that is fair to both the taxpayer and the IRS, applying the tax laws reasonably and impartially while striving for uniformity and consistency with respect to similarly situated taxpayers.[45] The Appeals officer is expected to approach settlement with a

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[35]Section 7405(b). *See Burnet v. Porter*, 283 U.S. 230 (1930). Section 6532(b) provides for a two-year period within which the government may commence the action (five years if the refund was induced by fraud or misrepresentation). However, regarding taxes specified in section 6212 (income, estate, gift, and so on), the IRS may instead send a deficiency notice (provided the assessment limitations period remains open) if the refund was made on the ground that the taxpayer's liability was less than reported. *Milleg v. Commissioner*, 19 T.C. 395 (1952).

[36]Reg. section 601.105(b)(4); *Bank of New York v. United States*, 170 F.2d 20 (3d Cir. 1948).

[37]*But see* section I.D. below regarding settlements in TEFRA partnership cases.

[38]*Caldwell v. Commissioner*, 202 F.2d 112 (2d Cir. 1953); *Rose v. Commissioner*, 55 T.C. 28 (1970); *Tollefsen v. Commissioner*, 52 T.C. 671 (1969), *aff'd* 431 F.2d 511 (2d Cir. 1970); *cf. Automobile Club of Michigan*, 353 U.S. 180 (1957) (commissioner not estopped to change mistaken legal position).

[39]Occasionally, an IRS Exam team may agree to forego examination of an item in the next examination cycle, or even skip the cycle altogether, in consideration of a concession by the taxpayer. Those informal agreements are not officially authorized and of dubious enforceability on a contractual basis. *Cf. Boulez v. Commissioner*, 810 F.2d 209 (D.C. Cir. 1987), *aff'g* 76 T.C. 209 (1981), *cert. denied* 484 U.S. 896 (1987) (refusing to enforce verbal compromise between taxpayer and IRS official when official had no authority to depart from regulations contemplating written agreement). It seems likely, moreover, that any estoppel claim by the taxpayer (see *infra* note 65) would stand little chance of success if the statute of limitations on refunds remained open for the year of concession at the time the IRS sought to avoid such an agreement. A key element of estoppel is detrimental reliance. *See Miller v. United States,* 500 F.2d 1007 (2d Cir. 1974) (government estopped from pleading statute of limitations in refund suit; IRS misled taxpayer to believe that a filing deadline, and thus refund period, had been extended); *Schuster v. Commissioner*, 312 F.2d 311 (9th Cir. 1962) (IRS estopped from holding bank liable for estate taxes where bank distributed trust assets based on prior IRS determination that no additional tax was due); *Vestal v. Commissioner*, 152 F.2d 132 (D.C. Cir. 1945) (government estopped to collect tax which had already been collected from another taxpayer who was barred by statute of limitations from obtaining refund). Detrimental reliance would be difficult to establish under the circumstances. Also, and in any event, estoppel principles are applied against the IRS with "the utmost caution and restraint." *Estate of Carberry v. Commissioner*, 933 F.2d 1124, 1127 (2d Cir. 1991) (quoting *Boulez v. Commissioner*, 76 T.C. 209, 214-15 (1981)).

(Footnote continued in next column.)

[40]IRM 8.1.1.2.

[41]Rev. Proc. 87-24, 1987-1 C.B. 720.

[42]*Id.*

[43]*Id.*; C.D.O. 60 (rev. 7).

[44]In collection cases, the taxpayer will often meet with an Appeals settlement officer.

[45]*See* IRM 8.1.1.3. According to the IRS, a fair and impartial resolution is one that reflects (1) on an issue-by-issue basis, the probable result in the event of litigation; or (2) mutual concessions for the purpose of settlement based on the relative strength of the opposing positions where there is substantial uncertainty of the result in the event of litigation. IRM 8.6.1.3.

judicial attitude.[46] He does not, however, have the authority to approve settlements. That generally resides at the level of the Appeals team manager, Appeals team case leader, and above.[47]

Significantly, unlike the revenue agent, the Appeals officer is authorized to entertain a proposed settlement based on hazards of litigation.[48] He may recommend that the IRS agree to split the additional tax attributable to an issue — a split-issue settlement[49] — or concede disputed items, in whole or part, based on the taxpayer's concession of other items — a mutual concessions settlement.[50] The Appeals officer also has substantially broader flexibility to negotiate accounting method issues. For example, perceived hazards may persuade him to recommend a year of change that is later than the earliest year under examination; or a section 481(a) adjustment in other than the year of change;[51] or even a cutoff method, coupled with the taxpayer's agreement to pay the time value of the tax savings obtained from the improper method.

The negotiating authority of the Appeals officer is not unfettered, however. He must justify a proposed basis of settlement in writing and may not advocate a basis of settlement:

- that is at variance with an institutionally controlled or coordinated issue, without prior clearance;[52]
- that is contrary to a TAM regarding an organization's exempt status or private foundation classification or an employee plan's qualification;[53]
- that is predicated on nuisance value;[54] or
- that trades a proposed penalty or addition to tax for a taxpayer concession on another issue without separately considering the merits of the penalty or addition.[55]

Other restrictions also apply to the Appeals officer's authority. Among other things, he may not:

- consider a case in which the taxpayer has filed a refund suit in federal district court or the Court of Federal Claims.[56] The Tax Division of the Justice Department (the Tax Division) has jurisdiction over such actions. The prohibition extends to all examined years (not just the years in suit) and to related cases;[57]
- consider an issue for which the taxpayer has requested competent authority consideration;[58]
- consider a case designated for litigation by IRS chief counsel;[59] or
- take action in a case, during the pendency of a criminal tax investigation or prosecution of the taxpayer, without the approval of IRS counsel.[60]

2. Settlement documentation. In nondocketed cases, the Appeals officer may use a standard 870-series form to document an agreed deficiency[61] or overassessment, provided that there are no mutual concessions.[62] However, if mutual concessions are involved or the taxpayer or IRS seeks greater finality, the Appeals officer normally will use one of the special ''AD'' forms:[63]

- Form 870-AD, ''Offer of Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment'';
- Form 890-AD, ''Estate Tax: Offer of Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment''; or
- Form 2504-AD, ''Excise and Employment Tax — Offer of Agreement to Assessment and Collection of Additional Tax and Acceptance of Overassessment.''

The AD forms differ from standard waiver-type forms in several respects:

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[46] IRM 8.6.1.3.4.

[47] C.D.O. 66 (rev. 15).

[48] *See* reg. section 601.106(f)(2) Rule II; IRM 1.2.1.8.4 and 8.1.1.2; IRS Policy Statement P-8-47.

[49] IRM 8.6.1.3.2; IRS Policy Statement P-8-48.

[50] IRM 8.6.1.3.1.

[51] Rev. Proc. 2002-18, *supra* note 21.

[52] *See* IRM 8.7.3.6 and 8.7.3.11; *cf.* C.D.O. 4-25.

[53] Reg. section 601.106(b), IRM 8.1.1.2.3. In other than EP or EO cases, Appeals is obligated to respect a TAM in the taxpayer's favor but, as noted (see *supra* note 18 and the accompanying text), it is not bound by a TAM or TEAM that is not in the taxpayer's favor.

[54] Reg. section 601.186(f)(2), Rule II; IRM 1.2.1.8.4 and 8.6.1.3.3., IRS Policy Statement P-8-47. ''Nuisance value'' refers to a concession that (1) is made solely to eliminate the inconvenience or cost of further negotiations or litigation and (2) is unrelated to the merits of the issues. Appeals will not seek or grant such a concession. Although the Internal Revenue Manual does not define the ''nuisance-value'' range, a settlement offer of 20 percent or less of the amount in dispute would normally be regarded as a nuisance-value settlement.

[55] *See* memorandum from David Robison dated June 21, 2004, *Interim Guidance on Appeals Policy Regarding Trading Penalties*. IRS counsel has adopted a similar policy. *See* Chief Counsel Notice CC-2004-036, *Doc 2004-18840, 2004 TNT 186-9*.

[56] IRM 8.7.1.3.4.2.

[57] IRM 8.7.1.3.1. However, Appeals may consider unrelated issues in nonsuit years with the approval of IRS counsel. Also, if the taxpayer makes a settlement proposal in a case under the jurisdiction of the Tax Division, and the proposal would effect nonsuit years in Appeals, the Appeals officer ordinarily will be given the opportunity to comment on the proposal before any acceptance. IRM 8.7.1.3.4.2.

[58] IRM 8.7.3.7.1. However, under certain circumstances, a taxpayer may elect Simultaneous Appeals consideration of a competent authority issue. *See* Rev. Proc. 2002-52, 2002-2 C.B. 242, *Doc 2002-16428, 2002 TNT 135-7*.

[59] IRM 8.1.1.2.2(b).

[60] IRS Policy Statement P-4-84.

[61] In a deficiency (pre-90-day) case, the parties may reach a partial agreement under which the taxpayer waives restrictions on assessment and collection with respect to a portion of the tax in dispute. Appeals will issue a deficiency notice for the balance.

[62] In lieu of Form 870, the Appeals officer may in some cases use Form 4862, ''Audit Statement-Income Tax Changes.'' Form 4862 combines adjustments to income, computation of tax, and waiver of restrictions on assessment and collection of the deficiency or acceptance of the overassessment. The form may not be used, however, in JCT cases; cases involving partial agreements; cases that require agreement forms with modifications or reservations; personal holding company cases; section 1311 cases; and cases in which the effective date of waiver is postponed.

[63] Additional AD forms are used in certain partnership administrative proceedings. Those forms and their effect are discussed in section 1.D. below.

- they use terms of offer and acceptance;
- they contain mutual pledges:
  - the IRS will not reopen the case unless there was fraud, malfeasance, concealment, or misrepresentation of a material fact; an important mistake in mathematical calculation; a deficiency or overassessment resulting from the application of the 1982 Tax Equity and Fiscal Responsbility Act partnership rules; or an excessive tentative carryback refund; and
  - the taxpayer will not claim or sue for a refund, except for amounts attributable to carrybacks as provided by law;
- the standard forms are effective as a waiver of restrictions on assessment when received. The AD forms become effective only on acceptance on behalf of the commissioner; and
- the suspension of interest under section 6601(c) is controlled by the date the AD form becomes effective. The date received is controlling in the case of the waiver forms.

In docketed cases settled by Appeals, Appeals prepares stipulated decision documents (discussed in section II.A.2. below) for submission by IRS counsel to the Tax Court.

3. Effect of settlement. The legal effect of waiver-type forms has been previously described in connection with examinations. As noted above, the AD forms, unlike the waiver forms, use terms of offer and acceptance. Despite that contractual terminology, the prevailing judicial view is that those forms do not constitute binding settlement agreements.[64] Nonetheless, several courts have applied the doctrine of equitable estoppel[65] to prevent taxpayers from suing for refunds after the period of limitations on assessment has run, in contravention of the terms agreed on by the parties.[66] As a result, even though the AD forms may not rise to the level of binding agreements, they can, at least in some judicial quarters, assume the attributes of a final settlement of tax liability for the year.

Regarding docketed Appeals cases, the legal effect of filed decision documents is described in section II.A.3. below.

C. Closing Agreements

Closing agreements constitute the primary administrative vehicle for achieving finality and closure in substantive tax disputes.[67] They are prescribed by statute[68] and used by Appeals, Exam, and occasionally IRS counsel. Unlike typical Exam and Appeals case-closing documentation, a closing agreement constitutes a binding agreement between the taxpayer and the IRS.[69] Historically, for that reason, the IRS has used closing agreements sparingly[70] and required that they be thoroughly reviewed before approval.

A closing agreement may determine (1) the amount, if any, of a taxpayer's liability for a particular tax and period (Form 886); (2) one or more separate items affecting such liability for that period or other periods (Form 906), including periods subsequent to the agreement; or (3) both.[71] A closing agreement ordinarily requires the IRS-prescribed form.[72]

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[64]*Whitney v. United States*, 826 F.2d 896 (9th Cir. 1987); *Stair v. United States*, 516 F.2d 560 (2d Cir. 1975); *Uinta Livestock Corp. v. United States*, 355 F.2d 761 (10th Cir. 1966); *Bennett v. United States*, 231 F.2d 465 (7th Cir. 1956); *Joyce, supra* note 28; *Davis v. Commissioner*, 29 T.C. 878 (1958); see *Botany Worsted Mills v. United States*, 278 U.S. 282 (1929). *But cf. Guggenheim v. United States*, 77 F. Supp. 186 (Ct.Cl. 1948), *cert. denied* 335 U.S. 908 (1949) (suggesting that Form 870-AD can qualify as a closing agreement).

[65]In general, the judicial doctrine of equitable estoppel seeks to redress injury resulting from detrimental reliance on the other party's words or actions. As articulated by the Tax Court, at least four essential elements must be shown: (1) a false representation or wrongful misleading silence; (2) an error in a statement of fact and not in an opinion or statement of law; (3) the person claiming the benefits of estoppel must be ignorant of the true facts; and (4) that person must be adversely affected by the acts or statements of the person against whom estoppel is claimed. *Estate of Emerson v. Commissioner,* 67 T.C. 612, 617-618 (1977).

[66]*See, e.g., Aronsohn v. Commissioner*, 988 F.2d 454, *Doc 93-4028, 93 TNT 72-24* (3d Cir. 1993); *Elbo Coals, Inc. v. United States*, 763 F.2d 818 (6th Cir. 1985); *Stair v. United States, supra* note 64; *General Split Corp. v. United States*, 500 F.2d 998 (7th Cir. 1974); *Cain*, 255 F.2d 193 (8th Cir. 1958); *Daugette v. Patterson,* 250 F.2d 753 (5th Cir. 1957), *cert denied* 356 U.S. 902 (1958); *Kretchmar v. United States*, 9 Cl. Ct. 191 (1985). But note that some courts have held that the application of estoppel is limited to issues actually contemplated by the parties at the time Form 870-AD was executed. *See Tyco Laboratories, Inc. v. United States*, 94-2 U.S.T.C para. 50,572 (D.N.H. 1994); *McGraw-Hill, Inc. v. United States*, 90-2 U.S.T.C. para. 50,053 (S.D.N.Y. 1990), *acq.* 1993-22 IRB 4.

[67]Offers in compromise are also prescribed by statute (*see generally* section 7122) and are generally used in collection matters. They allow for the compromise of the taxpayer's liability when there is doubt either as to collectibility or as to liability.

[68]*See generally* section 7121.

[69]In light of the binding nature of closing agreements, as discussed below, it is not surprising that the commissioner's delegation of authority to execute such agreements on behalf of the IRS, as set forth in C.D.O. 97 (rev. 34), is highly specific.

[70]In recent years, however, the IRS has made the closing agreement the centerpiece of a variety of dispute resolution or minimization programs. *See, e.g.*, Rev. Proc. 2005-12, 2005-2 IRB 311, *Doc 2004-24184, 2004 TNT 247-7* (establishing prefiling agreement program for LMSB taxpayers); Rev. Proc. 98-22, 1998-1 C.B. 723, *Doc 98-8590, 98 TNT 46-7* (establishing comprehensive employee plans compliance resolution system); Notice 98-21, 1998-1 C.B. 849, *Doc 98-11062, 98 TNT 63-14* (establishing worker classification dispute resolution program).

[71]Rev. Proc. 68-16, 1968-1 C.B. 770.

[72]Reg 601.202(b); *see Rohn v. Commissioner*, T.C. Memo. 1994-244, *Doc 94-5236, 94 TNT 105-19* (negotiations did not bind IRS before docketing of case in Tax Court and did not create closing agreement, even if considered to result in contract under general principles of contract law). *But see Bewkes v. United States*, 2000-1 U.S.T.C. para. 50,246, *Doc 2000-5400, 2000 TNT 83-17* (S.D. Fla. 2000) (letters of offer and acceptance established binding settlement agreement; held: section 7121 does not require execution of IRS form); *Spires v. United States*, 95-2 U.S.T.C. para. 50,613 (D.Ore. 1995) (similar result). It must be pointed out, however, that no particular IRS form is necessary to effectuate a binding settlement in a case pending before the Tax Court; *Manko v. Commissioner,* T.C. Memo. 1997-510; *Lamborn v. Commissioner*,

(Footnote continued on next page.)

Three conditions must be satisfied before the IRS will enter into a closing agreement:[73]

- the content of the agreement is satisfactorily agreed on;
- the agreement does not intrude on the jurisdiction of any court to determine the tax liability; and
- there appears to be an advantage to having the case permanently and conclusively closed, or good and sufficient reasons are shown by the taxpayer for desiring a closing agreement, and the IRS determines it will sustain no disadvantage by entering into such an agreement.[74]

Closing agreements are interpreted in accordance with principles of contract law.[75] In consequence, a court may find a closing agreement a nullity if the evidence demonstrates that an essential contractual predicate — a meeting of the minds — is absent.[76] Under contract law principles, a court will also refrain from considering extrinsic evidence in interpreting a closing agreement whose essential terms are unambiguous.[77] Nor will the court infer additional terms.[78] The *Bethlehem Steel* case[79] is illustrative. The Tax Reform Act of 1986 repealed the investment tax credit, but an off-code provision allowed steel manufacturers to elect to monetize a portion of their ITC carryovers as 1987 tax refunds. To accelerate the refund, Bethlehem entered into a closing agreement in which it agreed to reinvest the proceeds in plant and equipment. The agreement included an antiretroactivity clause stating that "no change or modification of applicable statutes will render this agreement ineffective with respect to the terms agreed to herein." Three months after Bethlehem received the refund, Congress amended the law retroactively to exclude 1986 ITCs from the refund computation. The government sued Bethlehem to recover a portion of the refund. Bethlehem claimed it was the parties' understanding that the refund was to be computed in accordance with preamendment law. Still, the company was unable to point to anything specific in the closing agreement that so stated. The court therefore concluded that the computation of the refund was not "a term of the agreement" protected by the antiretroactivity clause. It declined to infer additional terms from extrinsic evidence proffered by Bethlehem.

As mentioned, closing agreements are intended to be final and conclusive.[80] Thus, while a closing agreement relating to future periods will be subject to any change in the law applicable to those periods,[81] it will not be undone by legislation made retroactive to a year covered by the agreement if the legislation says nothing about its effect on closing agreements.[82] Moreover, unlike a contract — which potentially may be repudiated on a variety of grounds — a closing agreement may be set aside only for fraud, malfeasance, or a misrepresentation of a material fact.[83] "Fraud" for that purpose denotes an intentionally false factual representation going to the heart of the agreement, and must be shown by clear and convincing evidence.[84] "Malfeasance" indicates a violation of a public trust, or guilt with respect to some form of official act.[85] And a "misrepresentation" involves the furnishing of incorrect or incomplete factual information that goes to the express terms of the agreement and is detrimentally relied on, in good faith, by the other party. However, unintentional mistakes of fact or law are not misrepresentations for this purpose.[86]

T.C. Memo. 1994-515; *Haiduk v. Commissioner,* T.C. Memo. 1990-506, and this rule may even extend to nondocketed years of the taxpayer involving the same issue as the docketed case. *Manko, supra*.

[73] *See* Rev. Proc. 68-16, *supra* note 71; *see also* IRM 4.36.3.6.2 (providing that in JCT cases, closing agreements are not entered into before JCT approval).

[74] Reg. section 301.7121-1(a). Some reasons recognized by the IRS for using a closing agreement are to (1) determine the amount of a net operating loss, capital loss, or credit; (2) establish the future-year effect of a recurring issue, provided later tax treatment does not depend on factual circumstances of later years; (3) determine the amount of income from a transaction, the amounts of deductions, or the year of inclusion or deduction; (4) determine cost, fair market value, or adjusted basis at a given past date; (5) prevent whipsaws; and (6) memorialize a change in accounting method. *See* Rev. Proc. 68-16, *supra* note 71. IRM 8.6.1.3.8 provides the following additional guidance for cases in Appeals:

> Where the disposition involves mutual concessions and the subsequent tax effect is material, a closing agreement should be executed. Where there are no mutual concessions or where the tax effect is not material, a closing agreement is not required, but it may be executed if in the judgment of Appeals it is desirable or the taxpayer requests a closing agreement.

[75] *Smith v. United States*, 850 F.2d 242 (5th Cir. 1988); *United States v. Lane*, 303 F.2d 1 (5th Cir. 1962); *Rink v. Commissioner*, 100 T.C. 319, *Doc 93-4407, 93 TNT 78-19* (1993); *Temple v. United States*, 11 Cl. Ct. 302 (1986). The IRS position is that closing agreements are not, in fact, contracts, because they are creatures of statute; consequently, traditional contractual elements, such as consideration, are unnecessary to their validity. *See* FSA 001485; IRM 8.13.1.6.1.1. *But see United States v. Nat'l Steel Corp.*, 75 F.3d 1146, 1150, *Doc 96-3746, 96 TNT 26-15* (7th Cir. 1996) (stating that closing agreements, although not subject to state contract laws, "certainly are contracts in the ordinary legal sense of the term, because they contain binding promises.") (Posner, J.).

[76] *See Sergy v. Commissioner,* T.C. Memo. 1990-442 (so holding).

[77] *See, e.g., Smith, supra* note 75; *Geringer v. Commissioner*, T.C. Memo. 1991-32. It has been held that the premises underlying the agreement do not bind the parties, and the recitals are useful only in interpreting the agreement where ambiguity exists. *See* *Pack v. United States*, 992 F.2d 955, *Doc 93-5500, 93 TNT 103-18* (9th Cir. 1993); *Estate of Magarian v. Commissioner*, 97 T.C. 1 (1991).

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[78] *United States v. Bethlehem Steel Corp.*, 270 F.3d 135, *Doc 2001-27661, 2001 TNT 214-52* (3d Cir. 2001); *Estate of Magarian, supra* note 77.

[79] *Supra* note 78.

[80] Section 7121(b).

[81] Reg. section 301.7121-1(d).

[82] Rev. Rul. 56-322, 1956-2 C.B. 963.

[83] Section 7121(b).

[84] Rev. Rul. 72-486, 1972-2 C.B. 644.

[85] IRM 8.13.1.6.2.

[86] *See Commissioner v. Ingram,* 87 F.2d 915 (3d Cir. 1937) (upholding closing agreement against IRS despite taxpayer's erroneous representation about amount of his gross income; mistake was not deliberate); *Kercheval v. United States,* 99-1

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D. TEFRA Partnership Procedures

TEFRA established a set of special rules governing the examination of, and the resolution of disputes arising from, partnership income tax returns,[87] other than those of certain small partnerships.[88] The rules (which now apply to LLCs as well) are separately discussed because they add a significant layer of complexity to the settlement process.

First, although every partner in a TEFRA partnership is considered a party to the case and has a right to participate in every phase of an administrative proceeding,[89] not every partner is entitled to enter into a separate settlement with the IRS. In particular, a partner with a less-than-1 percent profits interest in a partnership with 100 or more partners will be bound by a settlement reached between the IRS and the TMP[90] if (1) the settlement agreement so states and (2) the partner has not previously provided the IRS with a written statement that the TMP does not have that settlement authority.[91] Similarly, a partner in a pass-through partnership (that is, a partnership that is a partner in another partnership)[92] who has not been previously identified to the IRS will be bound by a settlement entered into by the passthrough partnership or to which it is subject.[93]

A second, distinctive feature of the TEFRA partnership rules is that, unlike general Exam and Appeals settlements, partner-level settlements regarding partnership items (as well as partnership-level penalties and additions to tax) are similar to closing agreements. That is, they are binding on the parties and conclusive except in cases of fraud, malfeasance, or material misrepresentation.[94] Case-closing forms typically used by Exam in TEFRA partnership cases[95] for tax years ending after August 5, 1997, are[96] Form 870-LT, "Agreement for Partnership Items and Partnership Level Determinations as to Penalties, Additions to Tax, and Additional Amounts and Agreement for Affected Items" and Form 870-PT,

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U.S.T.C. para. 50,220, *Doc 1999-4117, 1999 TNT 22-12* (4th Cir. 1999) (upholding closing agreement that was based on what proved to be erroneous IRS interpretation of the law); Rev. Rul. 73-459, 1973-2 C.B. 415 (concluding that revenue agent's unintentional mistake in omitting deductions in computation on which a closing agreement was based was not a misrepresentation of a material fact for which agreement could be set aside).

[87]The mechanics of the rules may be briefly summarized as follows:

1. A partner is required to report his share of each partnership item (typically, an item that the partnership takes into account in preparing its income tax return) consistently with the partnership income tax return or to notify the IRS of any discrepancy. Sections 6221(a) and (b). Absent that notification, the IRS may make the partner's return consistent with the partnership return and summarily assess any resulting deficiency. Section 6221(c).
2. One partner, the TMP, speaks for the partnership in the event its income tax return is examined. The TMP is typically the general partner so designated by the partnership. Section 6231(a)(7). The TMP is required to keep the other partners informed. Section 6223(g).
3. The IRS may propose adjustments to the partnership return. If the proposed adjustments remain unagreed, it will issue a final partnership administrative adjustment (FPAA) to the partners. Section 6223(a). Either the TMP or other partners may challenge the FPAA in court before assessments of any deficiencies, and other items, attributable to partnership items are made. Sections 6225(a) and 6226(a) and (b).
4. The TMP or other partners may request the IRS to make administrative adjustments to the partnership return. Sections 6227(a), (c), and (d). If the IRS does not make them, the TMP or other partners may sue to require that the adjustments be made. Section 6228.
5. Any adjustment to the partnership return (including the application of any penalty, addition to tax, or additional amount relating to that adjustment), whether via administrative action or adjudication, is made at the partnership level (rather than, as in pre-TEFRA years, at the partner level). Section 6221. The adjustment is passed through to the partners. The IRS will compute any resulting deficiency or overassessment for each partner. Sections 6230(a) and 6231(a)(6).
6. The IRS generally has at least three years from the time the partnership return is filed (potentially longer if an FPAA is issued and longer still if it is challenged) to assess any such deficiency, as well as additions or an additional amount arising therefrom (rather than, as in pre-TEFRA years, whatever shorter assessment period might be left in the case of each individual partner). Sections 6229(a) and (g). If an individual partner enters into a settlement agreement with the IRS, however, the IRS has one year thereafter to assess the deficiency, additions, and so forth against the settling partner. Sections 6229(f) and 6231(b).

[88]A small partnership is defined as one having 10 or fewer partners each of whom is an individual (other than a nonresident alien); a C corporation; or an estate of a deceased partner.

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A husband and wife (and their estates) are treated as one partner for purposes of this definitition. Section 6231(a)(1)(B).

[89]Section 6224(a).

[90]The code notably does not require the IRS to keep partners informed of settlement negotiations with respect to partnership items and related matters. That is the TMP's responsibility. The time and place for all administrative proceedings are determined by the IRS and the TMP. Reg. section 301.6224(a)-1(a).

[91]Section 6224(c)(1); reg. section 301.6224(c)-1(a).

[92]Section 6231(a)(9).

[93]*See generally* reg. section 301.6224(c)-(2).

[94]*Toker v. United States*, 982 F. Supp. 197, *Doc 97-12312, 97 TNT 86-55* (S.D.N.Y. 1997) (holding that taxpayer was bound by executed Form 870-P despite later, more favorable settlements accorded others; request for administrative adjustment denied); FSA 200108022, *Doc 2001-5462, 2001 TNT 38-16*. Note that although agents generally do not have the authority to enter into binding settlement agreements with taxpayers, certain senior revenue agents (and higher-grade personnel) do have the authority to enter into and approve binding settlement agreements with partners in TEFRA partnership cases. *See* C.D.O. 209 (rev. 4).

[95]The 870-series partnership forms, as well as the Form 906 closing agreement, may also be used to effectuate partner settlements in TEFRA partnership cases in the Tax Court.

[96]For 1997 and prior years, Exam used Forms 870-L and 870-P, and Appeals used Forms 870-L(AD) and 870-P(AD).

''Agreement for Partnership Items and Partnership Level Determinations as to Penalties, Additions to Tax, and Additional Amounts.''

The forms used by Appeals for tax years ending after August 5, 1997, are Form 870-LT(AD), ''Settlement Agreement for Partnership Items and Partner Level Determinations as to Penalties, Additions to Tax, and Additional Amounts, and Agreement for Affected Items,'' and Form 870-PT(AD), ''Settlement Agreement for Partnership Items and Partner Level Determinations as to Penalties, Additions to Tax, and Additional Amounts.''

Although the language of Exam's and Appeals' forms differs,[97] both sets require execution by an IRS official to give effect to the form.[98] The effective date of settlement is pivotal from the assessment perspective. A partner's partnership items are converted into nonpartnership items when the government ''enters into a settlement agreement with the partner with respect to such items.''[99] The IRS then has one year (in the absence of an agreement between the parties allowing for a longer period) to assess any deficiency due to the converted items and affected items.[100]

What qualifies as a ''settlement agreement'' for purposes of the TEFRA partnership rules has proven controversial. The code does not define the term, nor is legislative history enlightening. In *Korpf v. Commissioner*,[101] the Tax Court confirmed that a properly executed 870-series form constitutes a settlement agreement for TEFRA purposes.[102] *Korpf* did not address, however, whether the form is the exclusive vehicle for effectuating a settlement. Two cases say it is not. In *Crnkovich v. United States*,[103] the Court of Federal Claims rejected the government's contention that settlement required the execution of Form 870-P. The taxpayer-partner had previously entered into a closing agreement which bound him to the result reached in a test case,[104] and the IRS had agreed to assess any deficiency within two years of the final decision in that case. The court held that the closing agreement constituted a settlement agreement for purposes of section 6224(c).[105]

The Fifth Circuit reached a similar result in *Treaty Pines Investments Partnership v. Commissioner*.[106] The taxpayer-partner sent a letter to the IRS accepting a settlement offer communicated through the TMP. Applying principles of contract law, the Fifth Circuit held that the letter sufficed to establish a settlement agreement. The government was unable to establish that the execution of additional forms would have amounted to anything more than an administrative convenience.

On a cautionary note, however, the Tax Court has held that the signing of the form is imperative if the partner understood that the IRS conditioned settlement on it.[107] Thus, in three related cases,[108] the court held that no settlement occurred because the taxpayer-partners failed to timely execute Form 870-P. Their counsel, although arguably having signaled their desire to settle, understood that additional settlement documentation would eventually be needed.[109]

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[97]Form 870-PT states that it constitutes an ''agreement'' between the IRS and the partner as to a determination of partnership items and that the taxpayer waives restrictions on assessment and collection of any deficiency attributable to those items. The agreement is ''conditional'' and does not become ''effective'' until signed by the commissioner or his delegate. In contrast, Form 870-PT(AD) states that the taxpayer ''offers to enter into a settlement agreement with respect to the determination of partnership items'' and to waive the restrictions on assessment and collection of any deficiency attributable to those items. The form further states that it is ''subject to acceptance for the Commissioner and will take effect as a waiver of restrictions on the date it is accepted.''

[98]*Id.*

[99]Section 6224(a).

[100]*See* section 6229(f).

[101]T.C. Memo. 1993-33.

[102]Because the code requires an ''agreement,'' the Tax Court interpreted the form in accordance with principles of contract law. *See also H Graphics/Access v. Commissioner*, T.C. Memo. 1992-345 (applying contract law principles in concluding that that Form 870-P, altered by taxpayer and countersigned by IRS, constituted a valid settlement; IRS's failure to note alteration was, at most, a unilateral mistake of fact and did not vitiate agreement).

[103]41 Fed. Cl. 168, *Doc 98-20433, 98 TNT 122-19* (1998), *aff'd per curiam* 202 F.3d 1325 (Fed. Cir. 2000). *Accord In re Crowell*, 2002-2 U.S.T.C. para. 50,659, *Doc 2002-21324, 2002 TNT 183-23* (6th Cir. 2002) (Form 906 constituted settlement agreement for TEFRA partnership purposes).

[104]This kind of agreement is commonly referred to as a piggyback agreement or stipulation to be bound. It is a useful device when a large number of cases share common questions of law and fact, and the IRS and the taxpayer in a particular case are amenable to being bound by the adjudicated result in a mutually acceptable test case. Piggyback agreements are not rooted in any judicial rule or procedure. They have been held to constitute a form of settlement agreement. *Monahan,* 321 F.3d 1063 (11th Cir. 2003). As such, their validity and interpretation are construed in accordance with principles of contract law. *Fisher v. Commissioner*, T.C. Memo. 1994-434, *Doc 94-8016, 94 TNT 168-13*.

[105]The government position in *Crnkovich* appears to have focused primarily on the fact that the closing agreement in dispute was a piggyback agreement and did not directly compromise any issue. *See Fisher, supra* note 104 (stating that piggyback agreement is not a compromise of matters in dispute, but instead prescribes procedures whereby such matters will be adjudicated).) The IRS acknowledges that, in appropriate circumstances, a closing agreement may qualify as a settlement agreement for purposes of section 6224. *See* IRM 4.31.2.6.6.2.1. Cf. *In re Crowell, supra* note 103.

[106]967 F.2d 206 (5th Cir. 1992).

[107]*Cinema '85 v. Commissioner*, T.C. Memo. 1998-213, *Doc 98-19633, 98 TNT 117-10*; *Greenberg Bros. Partnership #12 v. Commissioner*, T.C. Memo. 1998-146, *Doc 98-12981, 98 TNT 78-19*; and *First Blood Assoc., v. Commissioner*, T.C. Memo. 1998-228, *Doc 98-21020, 98 TNT 125-8, aff'd sub nom. Cinema '84 v. Commissioner per curiam on this issue, vac'd, rev'd, and rem'd on other issues*, 294 F.3d 432, *Doc 2002-12370, 2002 TNT 187-17* (2d Cir. 2002). That position has obvious significance beyond TEFRA. In general, taxpayers seeking to settle with the IRS would be well-advised to make certain they have timely taken all the steps called for by the IRS to effectuate the settlement.

[108]*Id.*

[109]Based on its factual findings, the court went on to conclude that it was unnecessary to reach the question whether, as contended by the IRS, the signing of an 870-series form or a

(Footnote continued on next page.)

Controversy has also arisen over the effect of executing the form. Does signing prevent the partner from later suing for a refund on an item he could have contested, but did not contest, in the partnership proceeding? Case law has not provided a consistent answer.

In *Alexander v. United States*,[110] the taxpayer-partner executed Form 870-P and paid a deficiency attributable to partnership items. Later, he sued for a refund on the grounds that the statute of limitations on assessing the deficiency, provided in section 6229, had expired when the assessment was made against him. The government countered with two arguments. First, it contended that section 7421(h) was a jurisdictional bar. That section provides that, except as provided by the TEFRA partnership rules themselves,[111] a taxpayer may not sue for a refund attributable to partnership items. The Fifth Circuit disagreed with the government's premise. It reasoned that the taxpayer's signing of the form converted all of his partnership items to nonpartnership items. Therefore, his claim was not based on a partnership items and the trial court had jurisdiction. The government's second argument was that the action was barred under the terms of Form 870-P, which states, ''If this form is signed for the Commissioner, the treatment of partnership items will not [be] reopened in the absence of fraud, malfeasance, or misrepresentation of fact; *and no claim for refund or credit based on any change in the treatment of partnership items may be filed or prosecuted*.''[112] [emphasis added] Again, the court disagreed. From its vantage point, the taxpayer's limitations argument was not an attempt to make a ''change in the treatment of any partnership item.''

A similar result obtained in *Browning-Ferris Industries, Inc. v. United States*.[113] After executing Form 870-P, the taxpayer-partner discovered it had been allocated too little ITC by the partnership for the year at issue. The government maintained that the taxpayer's subsequent refund suit, based on a claim of additional ITC, was barred by section 7421(h). Relying on *Alexander*, the trial court held that it had jurisdiction because the taxpayer's execution of the form converted its partnership items to nonpartnership items. Also, the court rejected the government's alternative argument that the suit ran afoul of the terms of the form. The court emphasized that section 6224 makes partnership settlement agreements binding with respect to the commissioner's ''determination'' of partnership items. That means, the court reasoned, that the form is conclusive, as a matter of law, solely for those items actually determined (that is, adjustments made) in the agreement.

In contrast, the Court of Federal Claims declined to follow *Alexander* in *Slovacek v. United States (Slovacek I)*.[114] It held that, having signed a Form 870-L(AD), the taxpayer-partner was precluded by section 7421(h) from arguing in a subsequent refund suit that the section 6229 limitations period had expired at the time of the assessment against him. The court rejected the taxpayer's position that, because the statute of limitations is part of subtitle F while the term ''partnerships item,'' as defined in section 6231, references subtitle A, the statute is a nonpartnership item. Rather, the court concluded that because the statute of limitations might be deemed to affect the amount, timing, and characterization of other partnership items for all partners, it fit within the broad definition of partnership item set forth in reg. section 301.6231(a)(3)-1(b). The court also brushed aside the taxpayer's alternative contention that the statute of limitations had been converted to a nonpartnership item by virtue of Form 870-L(AD). It reasoned that, applying *Alexander's* logic, any settlement by a partner with respect to a partnership item would be illusory, because the partner could later contest the same item once it had been converted to a nonpartnership item. Also, the court agreed with the alternative argument advanced by the government that, even if section 7421(h) did not apply, the taxpayer had, by signing Form 870-L(AD), waived his right under the express terms of the form to seek a refund with respect to any and all partnership items.

In late 2004 the Fifth Circuit revisited the section 7421(h) jurisdictional issue in *Weiner v. United States*,[115] a case involving facts similar to those in *Alexander*. Like the

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Form 906 closing agreement is always required to effectuate a settlement for purposes of section 6224(c). On appeal, the Second Circuit did not expressly disagree with the Tax Court's legal analysis but believed that the court had clearly erred in deciding that one of the taxpayer-partners understood the need for additional documentation.

[110]44 F.3d 328, *Doc 95-2157, 95 TNT 33-17* (5th Cir. 1995).

[111]Section 6231(c) permits a partner to claim and sue for a refund in four circumstances:

1. The IRS erroneously computed the deficiency or overassessment attributable to the IRS's making the partner's return consistent with the partnership return.
2. The IRS erroneously computed the deficiency or overassessment attributable to the application to the partner of a settlement, FPAA, or court decision.
3. The IRS failed to make a refund or allow a credit in the amount of the overpayment attributable to the application to the partner of a settlement, FPAA, or court decision.
4. The IRS erroneously imposed a penalty, addition to tax, or additional amount relating to an adjustment on a partnership item.

Any claim based on (1), (2), or (4) must be filed within six months after the IRS mails the partner its computation. A claim based on (3) must be filed within two years after the settlement is entered into, or the time expires for challenging the FPAA in court, or the court decision becomes final, whichever applies.

[112]Compare the following, noticeably broader language contained in Form 870-AD:

> No claim for refund or credit will be filed or prosecuted by the taxpayer for the years stated on this form, other than for amounts attributed to carrybacks provided by law.

[113]233 F. Supp.2d 1223, *Doc 2002-19456, 2002 TNT 164-12* (D. Ariz. 2002); *see also* subsequent opinion at 2003-1 USTC para. 50,369 (D. Ariz. 2003).

[114]96-2 U.S.T.C. para. 50,467, *Doc 96-22510, 96 TNT 156-12*; *see also Kaplan v. United States*, 133 F.3d 469, *Doc 98-1722, 98 TNT 6-7* (7th Cir. 1998) (holding that section 7421(h) barred the taxpayer's refund suit based on the section 6229 statute of limitations, despite prior conversion of taxpayer's partnership items to nonpartnership items).

[115]389 F.3d 152 (5th Cir. 2004), cert. denied.

Court of Federal Claims and other courts,[116] it concluded that the section 6229 limitations period is a partnership item for purposes of section 7421(h). The appeals court also significantly narrowed the ambit of *Alexander*, holding that a section 6224(c) settlement agreement converts only those partnership items specifically identified in the agreement.[117] Thus, because the section 6229 period was not mentioned in the Form 870-P executed by the taxpayer-partner, it remained a partnership item and his suit was barred by section 7421(h).[118]

In sum, it remains unclear under the case law whether the execution of an 870-series form (1) converts any and all, or just some, of the partner's partnership items to nonpartnership items for purposes of section 7421(h)'s jurisdictional bar; and (2) whether the terms of the form constitute a waiver of the partner's right to later contest any and all, or just some, partnership items.

A third, unique aspect of the TEFRA partnership rules is the ''consistent settlement'' principle. Section 6224(c) provides in pertinent part:

> If the Secretary or the Attorney General (or his delegate) enters into a settlement agreement with any partner with respect to partnership items for any partnership taxable year, the Secretary or the Attorney General (or his delegate) shall offer to any other partner who so requests settlement terms for the partnership taxable year which are consistent with those contained in such settlement agreement.[119]

Consistent settlement terms are those based on the same determinations with respect to partnership items or partnership-level determinations of any penalty, addition to tax, or additional amount that relates to partnership items.[120] The items must be (1) partnership items (or a partnership-level determination of any related penalty, addition to tax, or additional amount) for the partner who entered into the original settlement immediately before the original settlement; and (2) partnership items (or a partnership-level determination of any related penalty, addition to tax, or additional amount) for the partner requesting the consistent settlement at the time he files the request.[121]

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[116]*See, e.g., Chimblo v. Commissioner*, 177 F.3d 119, *Doc 1999-18495, 1999 TNT 100-8* (2d Cir. 1999); *Kaplan, supra* note 114; *Williams*, 165 F.3d 30, *Doc 98-25390, 98 TNT 157-13* (6th Cir. 1998) (unpublished table decision).

[117]The court sought to distinguish *Alexander* on the grounds that in the earlier case, the parties had agreed that the partnership limitations period was closed, in effect waiving the jurisdictional issue.

[118]The court's holding would suggest that a taxpayer-partner who executes an 870-series form is not foreclosed from further participation in the partnership proceedings with respect to items not identified in the form, because those items have not been converted. In contrast, the IRS position is that by signing the form, the taxpayer irrevocably removes himself from the proceedings.

[119]Outside the TEFRA partnership setting, the code imposes no explicit duty of settlement consistency on the commissioner. From time to time, however, the question has arisen whether the IRS must, under general legal principles, treat similarly situated taxpayers alike for purposes of settlement. Although case law can be read for the broad proposition that the IRS is under a duty of ''equality of treatment,'' *see Int'l Bus. Machines Corp. v. United States*, 343 F.2d 914 (Ct. Cl. 1965), *cert. denied* 382 U.S. 1028 (1966) (IRS abused its discretion in prospectively revoking beneficial private ruling given to taxpayer's competitor; by denying taxpayer similar ruling in the interim, IRS placed taxpayer at untenable competitive disadvantage); *Gateway Equip. Co v. United States*, 2003-1 U.S.T.C. para. 70,203 (W.D.N.Y. 2003) (IRS could not deny manufacturer's refund claim that sought same tax treatment accorded to other, similarly situated manufacturers), courts, in general, have shunned any rule that would call for strict settlement parity among similarly situated taxpayers. Under the prevailing judicial view, it is not enough

(Footnote continued in next column.)

for the taxpayer to show that other taxpayers have been treated more favorably. Rather, he must also establish that the disparate treatment complained of was the product of ''invidious discrimination,'' that is, an impermissible consideration such as a race, religion, or an arbitrary classification. *Bunce v. United States,* 28 Fed. Cl. 500, *Doc 93-6628, 93 TNT 125-17* (1993), *aff'd* 26 F.3d 138, *Doc 94-4196, 94 TNT 79-26* (Fed. Cir. 1994) (unpublished opinion), *cert. denied* 513 U.S. 104; *Penn-Field Industries, Inc. v. Commissioner*, 74 T.C. 720 (1980). In practice to date, this standard has proven virtually insurmountable. *See, e.g., Bunce, supra* (refusing to order IRS to settle with taxpayer-estate on favorable terms contemporaneously extended to similarly situated taxpayer by the same IRS Appeals office; other IRS Appeals offices had not made similar offers and, in any event, estate did not establish discriminatory motive); *Avers v. Commissioner*, T.C. Memo. 1988-176 (holding that tax-shelter investor was not entitled to favorable settlement terms offered other investors in same shelter for the year in dispute, because other offers were purportedly made in error and taxpayer failed to prove improper, discriminatory purpose); *Fresoli v. Commissioner*, T.C. Memo. 1988-384 (no showing by tax-shelter investor that he was the subject of an arbitrary classification);*Wooten v. Commissioner*, T.C. Memo. 1993-241 (denying tax-shelter investor's motion to compel discovery into IRS settlements in other cases involving same shelter; investor could not show he had received less favorable settlement offer than other investors or otherwise demonstrate that IRS had an established policy of settling similar cases in a particular manner; thus investor could not prove he had been singled out for less favorable treatment); *Hayes v. Commissioner*, T.C. Memo. 1994-491, *Doc 94-9244, 94 TNT 198-19* (holding that IRS did not act improperly in refusing to offer tax-shelter promoter settlement terms offered to passive investors in shelter; IRS had a rational basis for treating promoter less favorably than investors); *but cf. Sirbo Holdings, Inc. v. Commissioner,* 476 F.2d 981 (2d Cir. 1973) (IRS could not settle case of one taxpayer and simultaneously refuse to settle case of similarly situated taxpayer without explaining the basis for disparate treatment).

[120]Reg. section 301.6224(c)-3.

[121]*Id.* The Tax Court has added that the consistent settlement rule applies only with respect to partners in the same partnership. *See Vulcan Oil Tech. Partners v. Commissioner*, 110 T.C. 153, *Doc 98-8448, 98 TNT 44-11* (1998), *aff'd sub nom. Tucek v. Commissioner*, 99-2 U.S.T.C. para. 50,942, *Doc 1999-35453, 1999 TNT 215-45* (10th Cir. 1999) (unpublished opinion)) and *Drake Oil Technology Partners v. Commissioner*, 2000-1 U.S.T.C. para. 50,378, *Doc 2000-11213, 2000 TNT 75-8* (10th Cir. 2000) (unpublished opinion); *Boyd v. Commissioner*, T.C. Memo. 1992-626. Thus, the partners of Partnership A cannot demand terms consistent with a settlement offered to the partners of Partnership B, even if Partnership A is a clone of Partnership B.

Reg. section 301.6224(c)-3(b)(1) establishes several requirements with respect to consistent settlement terms. A consistent settlement must:

- be self-contained — a concession by one party with respect to a partnership item may not be based on a concession by another party with respect to any item that is not a partnership item other than a partnership-level determination of any penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item;[122]
- be identical to the original settlement (that is, the settlement on which the offered settlement terms are based);[123] and
- mirror the original settlement and may not be limited to selected items from the original settlement.

To obtain consistent settlement terms, a partner must submit a written statement to the IRS office that entered into the settlement.[124] The statement must:

- indicate that it is a request for consistent settlement terms under section 6224(c)(2);
- contain the name, address, and taxpayer identification number of the partnership and of the partner requesting the settlement offer (and, in the case of an indirect partner, of the passthrough partner through which the indirect partner holds an interest);
- identify the earlier agreement to which the request refers; and
- be signed by the partner making the request.[125]

The request for consistent settlement terms must be filed no later than the later of the 150th day after the day on which the notice of final partnership administrative adjustment is mailed to the TMP or, if the FPAA has been issued, the 60th day after the day on which the settlement agreement was entered into.[126]

Like the TEFRA settlement agreement concept, the consistent settlement rule has proven fertile ground for controversy. One question that has repeatedly arisen is whether the IRS has a duty to inform the partners of the original partner settlement. The code does not expressly impose such a duty. It might be argued that its existence is to be logically inferred from the right to make the request for a consistent settlement, which (so the argument goes) would be illusory without notice, at least when the original settlement is with a partner other than the TMP.[127] The IRS position, however, is that no duty exists, except in tax litigation.[128] That appears to be the judicial view at this time as well.[129]

A second area of controversy relates to the remedy available for a denial of consistent settlement terms. Section 6224(c)'s mandatory language — ''the Secretary or the Attorney General (or his delegate) *shall* offer'' — suggests that an action for mandamus might be appropriate if the complaining partner remains a participant in the partnership proceedings.[130] Assume, however, that the partner learns of the settlement only after his partnership items have been converted by way of prior settlement or adjudication, thereby removing him from the partnership proceedings. Does a cause of action exist if the IRS is at fault? Although ''yes'' may seem the intuitively fair answer, the law is uncertain.

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[122]In *Greenberg Bros. Partnership #4 v. Commissioner*, 111 T.C. 198, *Doc 98-26388, 98 TNT 164-12* (1998), *aff'd sub nom., Cinema '84 v. Commissioner, per curiam on this issue, vac'd, rev'd and rem'd on other issues*, 294 F.3d 432 (2d Cir. 2002), the taxpayer complained that the temporary version of the regulation (substantially identical to the final one) allowed the IRS to evade the consistent settlement rule merely by injecting a nonpartnership item into the settlement. The Tax Court upheld the temporary regulation nonetheless, characterizing it as legislative in nature and therefore entitled to a high degree of deference. The Second Circuit affirmed, although the court accorded the regulation only the substantial deference due an interpretative rule. The IRS has subsequently acknowledged that the use of a single settlement agreement to cover partnership and nonpartnership items ''would frustrate the intent of the consistent settlement rules.'' FSA 199917060, *Doc 1999-15650, 1999 TNT 84-129*.

[123]IRS counsel takes the position that, with respect to a multiyear settlement when all years are TEFRA partnership years and the adjustments for one year and the adjustments for other years are interdependent, the entire settlement agreement, and not just the settlement as it relates to one year, is subject to a request for consistent settlement terms. LGM TL-87.

[124]Reg. section 301.6224(c)-3(c)(1).

[125]Reg. section 301.6224(c)-3(c)(2).

[126]Section 6224; reg. section 301.6224(c)-3(c)(3).

[127]The TMP is the only partner with an affirmative obligation to provide other partners with notification of an administrative settlement entered into with the IRS. *See* reg. section 301.6223(g)-1(b)(1)(iv). It is noteworthy, however, that even if the TMP fails to fulfill that obligation, an IRS adjustment is not thereby invalidated. *See* section 6230(f).

[128]*See* FSA 001400. T.C. Rule 248 establishes special procedures governing the settlement of docketed TEFRA partnership cases. (The United States Court of Federal Claims, which like the Tax Court has original jurisdiction over TEFRA partnership disputes, see sections 6226(a)(3) and 6228(a)(1)(C), has adopted a similar rule. *See* Appendix Rule 7, RCFC.) Briefly, the rule allows the TMP to consent to entry of a stipulated decision, and his consent binds all partners. *See* T.C. Rule 248(a). The TMP's signature on the decision document constitutes a certification by her that no party objects to entry of decision. *Id.* Alternatively, absent that consent, and in the case of a partner who has elected to participate in the Tax Court proceedings and who enters into a settlement agreement or consistent agreement with the IRS, the IRS must promptly file with the court a notice of settlement agreement or notice of consistent agreement, whichever is appropriate, that identifies the participating partner who has entered into the settlement agreement or consistent agreement. Moreover, in the case of any partner (including a partner that has not elected to participate in the proceedings) who enters into a settlement agreement, the IRS must, within seven days after the settlement agreement is executed by both the partner and the IRS, serve on the TMP a statement that identifies the party to the settlement agreement; the date of the agreement; the year or years to which it relates; and the terms of the settlement as to each partnership item and the allocation of such items among the partners. Within seven days after receiving the statement required by that subparagraph, the TMP must serve on all parties to the action a copy of such statement.

[129]*See Vulcan Oil Tech. Partners, supra* note 121.

[130]*See Prochorenko v. United States*, 2000-1 U.S.T.C. para. 50,170, *Doc 2000-2020, 2000 TNT 12-12* (Fed. Cl.), *aff'd on other grounds* 243 F.3d 1359, *Doc 2001-8827, 2001 TNT 59-14* (Fed. Cir. 2001), in which the government asserted that mandamus is the taxpayer's sole remedy.

In *Monti v. United States*,[131] the IRS failed to timely notify the partnership TMP of a settlement, contrary to Tax Court Rule 248. On later learning of the settlement, the taxpayer-partner, who had already paid the deficiency, requested consistent terms and a refund. The IRS denied the request. In the ensuing refund suit, the government argued that a request for consistent settlement terms is a partnership item, and therefore the taxpayer's action was barred by section 7121(h). The Second Circuit disagreed. First, it pointed out that section 6231 defines a partnership item as "an item more appropriately determined at the partnership level than at the partner level." Whether a taxpayer is entitled to consistent settlement terms, the court continued, requires a partner-specific inquiry and therefore is not an item more appropriately determined at the partnership level. Next, the court observed that the right to consistent settlement terms was not among the items detailed in the definition of partnership item set forth in reg. section 301.6231(a)(3)-1. Lastly, the court noted that the right to consistent settlement terms is provided in subtitle F, while partnership items are defined with reference to subtitle A.[132]

The Federal Circuit is in accord. In *Prochorenko v. United States*,[133] it concluded that a partner's request for consistent settlement terms is not a partnership item, both because it requires a partner-level factual determination and because it is not enumerated in the section 6231 regulations. Thus, the taxpayer-partner's refund suit claiming wrongful denial of consistent settlement terms was not jurisdictionally barred by section 7121(h).[134]

Nevertheless, the IRS has acquiesced in neither *Monti* nor *Prochorenko*. Moreover, as mentioned, reg. section 301.6224(c)-3 requires items to be partnership items (or a partnership-level determination of any related penalty, addition to tax, or additional amount) for the partner requesting consistent settlement terms when he makes the request.[135] Interpreted literally, the regulation would rule out redress, regardless of the facts and circumstances, if the partner's items have already been converted at the time of the request. Such an interpretation might well be challenged by taxpayers as unreasonable. It would appear, however, at least under the Tax Court view, that the regulation is entitled to high deference.[136] The government may also draw encouragement from the Court of Federal Claims' opinion in *Slovacek v. United States (Slovacek II)*.[137] There, based on its own reading of section 6624, the court concluded that the consistent settlement principle applies only to items that remain partnership items to the requesting partner at the time of the request. Thus, the taxpayer-partner, having signed Form 870-L(AD), could not thereafter compel the IRS to offer him consistent settlement terms, despite his claim that the government had wrongfully denied him the benefit of more attractive terms offered to other partners. The court found that his signing of the form converted the items for which he sought consistent treatment to nonpartnership items.

E. National Settlement Initiatives

Faced with the specter of protracted and costly litigation over alleged tax shelters, as well as the formidable task of identifying taxpayers who participated in them, the IRS in recent years has announced several national settlement initiatives. Those programs — for example, the Son-of-BOSS, contingent liability shelter, and executive stock option initiatives — are aimed at resolving large numbers of pending and nascent disputes at the administrative level on an expeditious and uniform basis.[138] The IRS's efforts are commendable from the standpoint of administrative efficiency and even-handedness. They also raise an important question that (although not wholly procedural in nature) is worth briefly discussing: To what extent, if any, do the initiatives give the taxpayer an enforceable right to settle? Three theories are considered below: (1) contract, (2) estoppel, and (3) consistency.

Contract. Are the initiatives offers? Under contract law principles, an offer is understood as a manifestation of willingness to enter into a bargain, so made as to justify the addressee in understanding that his assent to that bargain is invited and will conclude it.[139] However, a manifestation of willingness to enter into a bargain is not considered an offer if the addressee knows or has reason to know that the person making it does not intend to conclude a bargain until he has made a further manifestation of assent.[140] In other words, contract principles recognize the occasionally murky distinction between actions sufficient to create a binding agreement on the one hand and preliminary steps on the other. Whether the parties have gone beyond preliminary stages and

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[131]223 F.3d 76, *Doc 2000-21961, 2000 TNT 165-6* (2d Cir. 2000).

[132]Interestingly, as noted earlier, a similar argument for treating the section 6229 assessment period as a nonpartnership item was unsuccessfully advanced in several cases.

[133]243 F.3d 1359 (Fed. Cir. 2001).

[134]The court went on to hold, however, that the taxpayer was not entitled to settlement terms consistent with those agreed on by the IRS and another partner, who similarly claimed that the IRS had denied him consistent settlement terms. The court reasoned that the settlement was based on the settling partner's claim for consistent treatment and, thus, not with respect to a partnership item. Consequently, the consistent settlement requirement was not implicated.

[135]When *Monti* and *Prochorenko* were decided, reg. section 301.6224(c)-3T, which is textually similar to reg. section 301.6224(c)-3, was in effect. It appears, however, that the government did not invoke that regulation.

[136]*See Greenberg Bros. Partnership #4, supra* note 122 (citing section 6230(k), which authorizes the IRS to prescribe such regulations as necessary to carry out the purposes of the TEFRA partnership rules).

[137]98-1 U.S.T.C. para. 50,397, *Doc 98-14819, 98 TNT 90-17*.

[138]*See, e.g.*, Ann. 2005-19, 2005-11 IRB 1 (stock option transactions); Ann. 2004-46, 2004-21 IRB 1 (Son-of-BOSS transactions); Ann. 2002-96, 2002-43 IRB 1 (COLI transactions); Ann. 2002-97, 2002 IRB 752 (basis-shifting transactions); Rev. Proc. 2002-67, 2002 C.B. 733 (contingent liability shelter).

[139]*Restatement, Contracts 2d* section 24 (1981).

[140]*Id.*, section 26.

actually concluded an agreement is a question of intent.[141] Intent, in turn, is an objective concept and is typically discerned from the words chosen by the parties. The parties may intend a current, binding agreement based on their manifestations of mutual assent, even though a formal writing is anticipated in the future.[142] Conversely, the parties' steps may not give rise to a binding agreement if there is no intention to be bound until the execution of a final document.[143]

The use of fully standardized language in the IRS settlement initiatives has not been the norm. Nonetheless, three points are notable:

1. Taxpayers typically must file an "election" to participate. The initiatives generally caution that taxpayers may be required to provide additional information in order to settle.

2. The signing of a closing agreement setting forth the terms of settlement is mandatory.

3. The filing of an election to participate does not bind the taxpayer to enter into the closing agreement.

Those factors lend themselves to the argument that the expression of settlement terms by the IRS in its initiatives is a preliminary step toward settlement, even though further negotiations are not invited. At the very least, it may be plausibly argued by the IRS that no binding agreement is intended unless and until a closing agreement is executed by both sides. And courts in any event are unlikely to find enforceable contractual rights without a closing agreement[144] in the prescribed form.[145] Thus, any contention by the taxpayer that the announced terms and an election to participate, by themselves (that is, without a closing agreement) create enforceable contract rights is not likely to meet with judicial receptivity.[146] It is also difficult to imagine an electing taxpayer successfully arguing that the IRS cannot refuse to enter a closing agreement (that is, that the parties have entered into an agreement to agree) when he is not bound.

Estoppel. Estoppel principles similarly would seem to hold little advantage for a disappointed taxpayer. Research uncovers a few exceptional estoppel-hued cases where the taxpayer's settlement expectations have been rescued. In *Vishnevsky v. United States*,[147] for example, the IRS sent the taxpayer a notice stating that an overassessment that had been determined on examination for one year would be credited against deficiencies for other years when the deficiencies were finally determined. The refund period for the overassessment year expired while the deficiencies were in litigation. Subsequently, the IRS refused to give the taxpayer credit for the overassessment because of the running of the statute of limitations. The Seventh Circuit held that the issuance of a writ of mandamus was proper to compel the IRS to reduce the deficiencies. First, the court found that the taxpayer and his counsel had reasonably relied on the IRS's promise that credit would be given. Second, it concluded that the written notification created a peremptory duty on the part of the commissioner to perform a nondiscretionary act. Finally, the court noted that running of the limitations period had left the taxpayer without an adequate remedy at law.

Similarly, in *First Federal Savings & Loan v. Baker*,[148] the Fourth Circuit held that the taxpayer was entitled to mandamus relief. The taxpayer and the government had settled a refund suit on terms that provided for the filing of carryback refund claims by the taxpayer for earlier years and the taxpayer's concession of loss carryovers to later years. On the taxpayer's filing of the refund claims, the parties discovered that the statute of limitations on refund had run; consequently, the government refused to make the refunds. Under the circumstances, the appeals court believed the taxpayer had a clear right to the refunds, the government had a clear duty to pay them, and the taxpayer had no other adequate remedy at law.

As noted elsewhere herein, however, estoppel is applied against the government with caution and requires a showing of reasonable reliance and detriment.[149] Those elements could well pose insurmountable barriers for the taxpayer. First, the IRS's initiatives do not categorically promise that settlement terms will be extended to all comers. That throws into question the reasonableness of the taxpayer's reliance. Second, as to detriment, it has been held that this element contemplates loss of a legal right (for example, the right to recover an overpayment because of the running of the statute of limitations);[150] merely having to pay taxes that are legally owed does not qualify as a detriment.[151] Thus, the taxpayer cannot simply point to disappointed expectations (that is, having to pay more tax than would have been required under an initiative) to support his estoppel claim.

Consistency. From the mainstream judicial vantage, as noted earlier, the IRS is not bound by any categorical duty of settlement consistency.[152] At the very least, however, taxpayers have a due-process right to be free from

[141] *See Adjustrite Sys. v. GAB Bus. Servs.*, 145 F.3d 543, 548-49 (2d Cir. 1998) ("The key [in determining whether a preliminary agreement is binding] is the intent of the parties: whether the parties intended to be bound, and if so, to what extent. To discern that intent a court must look to the words and deeds [of the parties] which constitute objective signs in a given set of circumstances. Subjective evidence of intent, on the other hand, is generally not considered") [internal quotations and citation omitted].

[142] *See Restatement, Contracts 2d* section 27.

[143] *See* A. Corbin, *Law of Contracts* section 30 at 47 (1952).

[144] *See supra* note 64; *Wolverine, Ltd. v. Commissioner,* T.C. Memo. 1992-669 (holding that written settlement plan entered into by partnership and IRS was not a binding settlement agreement, but rather a conditional and precursory agreement).

[145] *See supra* note 72.

[146] *See Klein*, 899 F.2d 1149 (11th Cir. 1990) (IRS not bound by letter from counsel which made settlement offer that called for execution of a closing agreement).

[147] 581 F.2d 1249 (7th Cir. 1978).

[148] 860 F.2d. 135 (4th Cir. 1988).

[149] *See supra* notes 39 and 65 and the accompanying text.

[150] *Segel*, 97-1 U.S.T.C. para. 50,404 (S.D. Fla. 1997); *Benson*, 96-2 U.S.T.C. para. 50,492 (D. Colo. 1996).

[151] *Id.*

[152] *See supra* note 119 and the accompanying text. It is interesting to note that at least one taxpayer has recently argued

(Footnote continued on next page.)

invidious discrimination in the settlement process.[153] To establish invidious discrimination, the taxpayer must demonstrate two facts: (1) other, similarly situated taxpayers were treated more favorably for settlement purposes; and (2) the taxpayer was singled out based on an improper motive, which may include an arbitrary classification.[154] As mentioned, taxpayers generally have been unsuccessful in meeting their burden of proof. That is due, at least in part, to judicial reluctance to permit broad discovery aimed at establishing the existence of an IRS settlement practice or policy favoring other taxpayers (Prong 1).[155] A national settlement initiative, however, would seemingly go far in making a prima facie case on this score. As to Prong 2, case law in the tax area provides little insight into what the courts may deem arbitrary or irrational from the standpoint of settlement design or implementation.[156] Reasonableness is a factual question. A related, threshold issue of importance is whether the taxpayer may seek judicial review of an IRS determination of ineligibility under an initiative. Some initiatives state that a denial of participation is not subject to judicial review,[157] and the government has taken that position in litigation.[158] The legal basis for the IRS position is not entirely clear. It is worth noting, however, that a strong presumption exists that the actions of an administrative agency are subject to judicial review,[159] and that principle has been applied to the IRS.[160] Congress can, of course, commit action to agency discretion, but nothing in the code evinces a clear-cut intent to give the IRS unfettered discretion in administering a settlement initiative of national scope.

In sum, it seems unlikely that the taxpayer who seeks the benefits of an announced settlement initiative would have much success under a contract or estoppel theory. However, a claim may exist if the taxpayer can show inconsistent treatment without a rational foundation. It remains to be seen what sorts of classifications might be considered unreasonable in those programs and, importantly, whether the IRS can insulate its eligibility determinations from judicial scrutiny.

F. Administrative Dispute Resolution Tools

A discussion of the procedural aspects of settlement at the administrative level would not be complete without an acknowledgement of some of the more recent and significant IRS procedural innovations designed to encourage and facilitate the settlement of examined cases.

1. Accelerated issue resolution (AIR). Introduced in 1994,[161] the AIR program is designed to expeditiously resolve examination issues in coordinated industry cases that are the same or similar to issues resolved by Appeals for other tax years. In effect, AIR allows the parties to import an Appeals settlement (including a hazards-based settlement) into the examination case, thereby conserving the parties' time and resources.

AIR is optional. The taxpayer initiates the process by submitting a written request that contains:

- a complete statement of the issues, facts, law, and arguments;
- a statement as to whether the taxpayer has ever applied for competent authority assistance for the AIR issues for the years under consideration or for prior years and whether the taxpayer intends to seek relief from double taxation for the AIR issues;
- true copies of all contracts and pertinent documents as well as certified English translations of any applicable foreign laws and copies of those laws;
- a statement that the inspection or examination of the books and records under the AIR procedures will not preclude or impede a later inspection or examination and that the IRS will not have to comply with the procedural reopening requirements for the later inspection or examination; and
- a perjury statement.

Generally, the LMSB team manager decides which issues in the request will be accepted for consideration in an

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that a particular settlement initiative constituted a rule the IRS was required to follow under the *Accardi* doctrine (*see Accardi v. Shaughnessy,* 347 U.S. 260 (1954)), which generally requires an agency to follow the rules and procedures it has voluntarily established. *See Black & Decker Corp. v. United States*, 2004-2 U.S.T.C. para. 50,359, *Doc 2004-20637, 2004 TNT 205-6* (D. Md. 2004), *appeal pending*. The court was not required to reach this contention, however.

[153]*Id.*

[154]*See Bunce, supra* note 119; *Penn-Field Industries, supra* note 119. Courts have not addressed the quantitative aspects of Prong 1 in a tax setting. It is probably safe to say, however, that merely demonstrating that a number of other taxpayers happened to fare better would not prove sufficient.

[155]*See Penn-Field Industries, supra* note 119; *Wooten, supra* note 119.

[156]The Tax Court has upheld distinctions based on the year of investment, *see Avers, supra* note 119; and the status of the taxpayer as a promoter versus passive investor. *See Hayes, supra* note 119.

[157]*See* Ann. 2004-46, *supra* note 138 (stating that denial of taxpayer's request to participate is not subject to judicial review); Ann. 2002-97, *supra* note 138 (similar).

[158]In *Black & Decker Corp., supra* note 152, the taxpayer applied for a waiver of accuracy-related penalties as provided by the disclosure initiative set forth in Ann. 2002-2, 2002-1 C.B. 304. The IRS denied the application and asserted that the exercise of its discretion under the initiative was not subject to judicial review. *See Plaintiff's Memorandum in Opposition to Defendant's Motion for Summary Judgment on Plaintiff's Affirmative Defenses and in Support of Its Own Cross-Motion for Summary Judgment on Defendant's Counterclaim*. In the ensuing refund suit, the court decided for the taxpayer on the merits and thus did not reach the penalty issue.

[159]*Dunlop v. Bachowski,* 421 U.S. 560, 567 (1975); *Abbott Laboratories v. Gardner,* 387 U.S. 136, 140-141 (1967); *United States v. Winthrop Towers,* 628 F.2d 1028, 1032-1035 (7th Cir. 1980). This principle is codified in the Administrative Procedure Act, 5 U.S.C. sections 701-706.

(Footnote continued in next column.)

[160]*Mailman v. Commissioner*, 91 T.C. 1079 (1988) (holding that the commissioner's refusal to waive substantial understatement penalty was subject to judicial review); *Estate of Gardner*, 82 T.C. 989 (1984) (holding that the commissioner's refusal to extend time for filing tax return was subject to judicial review).

[161]Rev. Proc. 94-67, 1994-2 C.B. 800, *Doc 94-9383, 94 TNT 202-10*; *see* IRM 4.45.15.4.4.

AIR agreement. He has the authority to entertain a settlement offer that applies the Appeals settlement to the issue(s) in a later or earlier open year if all of the following criteria are satisfied:[162]

- the facts (which must be fully developed) are substantially the same as the facts in the year settled by Appeals;
- the relevant legal authority is unchanged;
- Appeals settled the issue independently of other issues; and
- the issue was settled with respect to the same taxpayer (including consolidated and unconsolidated subsidiaries) or another taxpayer who was directly involved in the same transaction or taxable event in the settled year.

A variety of issues are excluded from AIR, including any of the following:[163]

- an issue in a case outside the jurisdiction of the industry director;
- an issue whose resolution is contrary to a private letter ruling, technical advice memorandum, or closing agreement previously issued to or entered into with the taxpayer, or is contrary to any proposed position indicated by the IRS with respect to a private letter ruling request that was withdrawn following notification by the IRS that it would take a position adverse to that sought by the taxpayer;
- an issue that is designated for litigation by IRS counsel; or
- an issue that requires approval or assistance from another office or function.

An AIR settlement is memorialized via Form 870-AD or a Form 906 closing agreement, which must be approved by the LMSB territory manager and may be executed on behalf of the IRS by the LMSB team manager.[164]

2. Early referral. Introduced in 1994 and codified in 1998 as section 7213, early referral, now set forth in Rev. Proc. 99-28,[165] is an optional procedure designed to remove ''logjam'' issues from an ongoing examination, thereby allowing other issues to be resolved more expeditiously while Appeals simultaneously works to resolve the referred matter. The program has not proved especially popular, perhaps because of a taxpayer perception that the carveout of issues reduces mutual-concession flexibility.

An eligible early referral issue is one that:

- if resolved, can reasonably be expected to result in a quicker resolution of the entire case;[166]
- both the taxpayer and Exam agree should be referred to Appeals early;
- is fully developed; and
- is part of a case where the remaining issues are not expected to be completed before Appeals could resolve the early referral issue.

An ineligible issue is one:

- for which a 30-day letter has been issued;
- that is not fully developed;
- in which the remaining issues in the case are expected to be completed before Appeals could resolve the early referral issue;
- that is designated for litigation by the IRS counsel;
- 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
- that is part of a whipsaw transaction.

Early referral is initiated by the taxpayer's submission of a written request that (1) states each issue for which early referral is requested; (2) contains a brief discussion of the material facts and an analysis of the facts and law as they apply to each issue; and (3) contains a perjury statement. The process is subject to Exam approval. Exam will issue a notice of proposed adjustment for each approved issue. The taxpayer is required to respond to each notice in a protest-like fashion. Approved issues are then referred to Appeals, which assumes jurisdiction over them, while Exam continues to work on other issues. If an early referral issue is resolved, Appeals will ordinarily use a Form 906 closing agreement to memorialize the agreement of the parties.[167] If an early referral issue remains unresolved, the taxpayer may request post-Appeals mediation (described hereinafter). Without a substantial change in circumstances, Appeals will not reconsider an unagreed early referral issue if the entire case is later protested.

3. Fast-track. In the past few years, both LMSB and SB/SE have initiated fast-track programs[168] that use an Appeals representative to help facilitate the resolution of unagreed issues while the case remains under Exam jurisdiction. Significant features in common include:

- the procedures are optional;
- either party may request fast-track — both must agree;
- eligible issues must be fully developed;
- the results are nonbinding, nonprecedential, and confidential;
- persons on both sides with decisionmaking authority must attend the fast-track sessions; and
- the procedures cannot be utilized after the 30-day letter is issued.

In addition to similarities, the LMSB and SB/SE programs also differ in some respects. First, SB/SE fast-track is projected to take 30 or 40 days. Because of the frequently greater complexity of LMSB issues, the LMSB version budgets up to 120 days. Second, because SB/SE and LMSB stakeholders are fundamentally different, the programs exclude different kinds of issues from eligibility. Perhaps the most significant dissimilarity between

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[162]C.D.O. 236 (rev. 3).

[163]Rev. Proc. 96-47, *supra* note 161, para. 3.02.

[164]C.D.O. 236 (rev. 3).

[165]1999-2 C.B. 109, *Doc 1999-22858, 1999 TNT 127-14*.

[166]The revenue procedure specifically provides that eligible issues include involuntary accounting method change issues, employment tax issues, and employee plan issues.

[167]If JCT review is required, the IRS will not sign until after that review is completed.

[168]*See* Rev. Proc. 2003-40, 2003-1 C.B. 1044, *Doc 2003-13535, 2003 TNT 107-12* (establishing LMSB fast-track mediation and settlement); Rev. Proc. 2003-41, 2003-1 C.B. 1047, *Doc 2003-13532, 2003 TNT 107-13* (establishing SB/SE fast-track mediation).

the two programs until recently was the role played by the Appeals representative. In SB/SE fast-track, the Appeals representative played a purely facilitative role. The parties were expected to resolve the dispute themselves without evaluative input. In contrast, under LMSB fast-track, the Appeals representative may play an evaluative role. Thus, he may propose a basis of settlement for the fast-track issue or issues, including a hazards basis. Moreover, despite the normal limitations on Exam's settlement authority, the parties are free to accept and adopt the recommendation. Appeals recently announced that the Appeals representative may now play a similar, evaluative role in SB/SE fast-track.[169]

The settlement terms in the fast-track session are set forth in a session report signed by the parties. The signing does not constitute a final settlement, but it is anticipated, in general, that the basis of settlement will not be subsequently modified by the parties. In LMSB fast-track, the Appeals representative may close the fast-track case under established Appeals case-closure procedures (for example, using Form 870-AD or Form 906). Alternatively, LMSB and the taxpayer may agree on LMSB case-closing authority. In that case, the fast-track issue is included as an agreed issue in the examination report. Presumably, in light of the recent expansion of the Appeals representative's role in SB/SE cases, SB/SE fast-track will establish similar procedures. Previously, if agreement was reached under SB/SE fast-track, the case was closed in accordance with normal Exam case-closure procedures.

4. Post-Appeals mediation. Dating back to 1995, this program is currently open to all taxpayers.[170] Its objective is to assist the parties, through mediation, to resolve issues remaining unresolved after normal Appeals consideration of the case (other than a docketed case). The process is voluntary, optional, nonbinding, nonprecedential, and confidential. It is commenced by the taxpayer's submission of a written request, which must be approved by an Appeals team case leader or Appeals team manager.

Issues eligible for mediation include legal issues, industry specialization issues, and coordinated issues. Issues that are ineligible include collection issues, issues for which mediation would be inconsistent with principles of sound tax administration, and issues with respect to which the taxpayer did not act in good faith during the normal appeals process.

If Appeals approves the request, the parties are expected to sign a mediation agreement within three weeks, setting forth the issues for mediation and the ground rules of the mediation, and commence mediation within 60 days thereafter. The use of an Appeals mediator is mandatory. However, at the taxpayer's option and with IRS consent, a third-party comediator may also be employed at the taxpayer's expense.

The parties provide the mediator(s) with a premediation submission, consisting of a brief discussion of facts and law and accompanied by exhibits, if any. The mediation typically involves one or more sessions. The parties make opening statements in a joint session and then have an opportunity to caucus privately with the mediator(s).[171] At the conclusion of the mediation, the mediator(s) prepare a report indicating which issues, if any, have been resolved. Normal Appeals case-closing procedures apply.

II. Settlements in Docketed Cases

A. Tax Court

1. Settlement authority. A taxpayer may challenge an asserted tax deficiency (as defined in section 6212) in the Tax Court and also claim an overpayment in the same case. The Tax Court has both deficiency and overpayment jurisdiction.[172] IRS counsel is charged with defending the commissioner's determinations in that venue.[173] Counsel is vested with broad settlement authority. In cases previously considered by IRS Appeals, whether in nondocketed[174] or docketed status,[175] counsel's settlement jurisdiction is exclusive. The failure of Appeals and the taxpayer to agree on settlement terms does not prevent counsel from settling the case. Counsel will settle a case when the evidence, law, and other factors justify settlement. It must be emphasized, however, that Appeals and counsel play significantly different roles (settlement and defense, respectively) in the tax controversy process. For that reason, counsel ordinarily will not engage in serious settlement deliberations until the case is fully developed for trial. That means that the taxpayer will have to endure the expense and inconvenience of discovery and can expect a thorough sifting of the evidence.

In the Tax Court, responsibility for management of the case and face-to-face discussions with the taxpayer or his representative falls to the IRS trial attorney (or special trial attorney in large-dollar or high-profile cases). Like the Appeals officer, the trial attorney may negotiate hazards-driven split-issue and mutual-concession settlements and has broad flexibility in dealing with accounting method issues. He does not have settlement authority, however.[176] That typically resides at the level of the associate area counsel and above. Also like the Appeals officer, the trial attorney is expected to support any proposed basis

[169]*See* ''Fast-Track Settlement Now Available to Small Businesses,'' *Doc 2005-8988, 2005 TNT 82-2*.

[170]*See* Rev. Proc. 2002-44, 2002-2 C.B. 10, *Doc 2002-13807, 2002 TNT 111-12*.

[171]For an in-depth discussion of the process, as well as strategic considerations, see Ronald A. Stein, ''Make the Most of Recently Expanded IRS Mediation Opportunities,'' 70 *Practical Tax Strategies* 144 (2003). In late 1999 Appeals also announced a two-year test of post-Appeals binding arbitration, 2000-1 C.B. 317, which was subsequently extended for an additional year. *See* Ann. 2002-60, 2002-26 IRB 1, *Doc 2002-13801, 2002 TNT 111-17*. Arbitration was limited to factual issues and the program was not popular.

[172]*See* sections 6213(a) and 6512(b).

[173]Section 7452.

[174]If settlement is not reached in a case that was protested directly to Appeals from the examination, Appeals will issue the deficiency notice that becomes the basis of the Tax Court's jurisdiction.

[175]As noted earlier, Appeals ordinarily will be given the opportunity to settle docketed cases that it did not previously consider. *See* Rev. Proc. 87-24, *supra* note 41.

[176]*See* C.C.D.O. 35.8.4.1.

of settlement in writing[177] and to avoid nuisance value settlements. Also, he is required to coordinate with the Tax Division regarding any related tax litigation pending in other venues. In settling tax cases under its own jurisdiction, the Tax Division reserves the right to resolve any and all pending related tax disputes.[178]

2. Settlement documentation. A Tax Court settlement is normally evidenced by a stipulated decision,[179] signed by the taxpayer[180] (or his duly authorized representative) and the appropriate IRS counsel designee. The wording varies with the nature of the dispute.[181] Significantly, however, the filing of the stipulated decision is not a prerequisite to settlement. The Tax Court has made it clear that the parties' actions, measured against contract law principles, can give rise to a binding settlement.[182] Thus, even if the taxpayer objects that he did not intend to settle, the court may conclude that a settlement occurred if it finds an objective manifestation of mutual assent (for example, offer and acceptance), the bedrock of contract formation.[183]

The Tax Court has made it equally clear that repudiation of a settlement, when one is found to exist, will pose a formidable challenge. In *Adams v. Commissioner*,[184] it described the minimum threshold:

> The party seeking modification . . . must show that the failure to allow the modification might prejudice him. . . . Discretion should be exercised to allow modification where no substantial injury will be occasioned to the opposing party; refusal to allow modification might result in injustice to the moving party; and the inconvenience to the Court is slight.[185] [Citations omitted.]

Subsequently, in *Dorchester Industries*,[186] the court held that a much stiffer standard applies when (as often occurs) the case has been stricken from the trial calendar with the understanding that settlement has been reached. Specifically, the court declared that in those circumstances, it will not allow repudiation in the absence of a showing of lack of formal consent, fraud, mistake, or some similar grounds.[187] Thus, the taxpayer in a recent case[188] was stuck with the terms of a qualified offer[189] made to IRS counsel. The offer was accepted, creating a binding agreement, and the case was continued from the trial calendar. Invoking *Dorchester*, the court held that the taxpayer could not thereafter modify the terms of the settlement to reduce the deficiency by net operating loss carrybacks that the offer failed to take into account.

As difficult as repudiation of a settlement is before a decision is entered, seeking to overturn a settlement once the stipulated decision has been entered and become final poses an even greater hurdle. The Tax Court construes its authority to relieve a party of a final decision narrowly. Specifically, the court allows a final decision to be vacated only if it is shown that (1) fraud was perpetrated on the court or (2) the court never acquired subject matter jurisdiction in the first place.[190] In that respect, the Tax Court differs from the other tax forums — the federal district courts, bankruptcy courts, and Court of Federal Claims. The latter permit a case to be reopened for up to one year after entry of final judgment[191] and recognize a much broader array of grounds for granting that relief.[192] The more restrictive Tax Court position is premised on section 7481. That statute provides that a Tax Court decision becomes ''final'' on the later of various dates linked to whether an appeal is filed, a petition for certiorari is filed, and so on. The crux of the position is that, by meticulously defining the date of finality, the code inferentially deprives the court of jurisdiction to modify a decision after that date.[193] *Estate of Smith v.*

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[177]C.C.D.O. 35.8.4.2.

[178]*See* C.C.D.O. 35.8.10.5.

[179]It is also possible to resolve separate issues in the case by the filing of a stipulation of settled issues.

[180]In Tax Court TEFRA partnership proceedings, as earlier noted, *see supra* note 128 and the accompanying text, the TMP may sign a stipulated decision on behalf of the other partners. *See* T.C. Rule 248(a). Alternatively, the IRS may use an 870-series form or Form 906 closing agreement to settle with individual partners in those cases. The IRS must notify the court of those individual settlements. *Id.*

[181]In an individual income tax or gift tax case, for example, the decision will recite the taxpayer's liability for and the amount of any deficiency or entitlement to and amount of any overpayment. When an overpayment exists, a separate stipulation supporting the overpayment is also required to be submitted. *See* section 6512(b)(3).

[182]*Robbins Tire & Rubber Co. v. Commissioner*, 52 T.C. 420, 435-436 (1969) (holding that the compromise and settlement of tax cases is governed by general principles of contract law); *Manko v. Commissioner*, T.C. Memo. 1995-10, *Doc 95-579, 95 TNT 8-17* (similar).

[183]*See Dorchester Industries, Inc. v. Commissioner*, 108 T.C. 320 (1997), *aff'd* 208 F.3d 205 (3d Cir. 2000).

[184]85 T.C. 359 (1985).

[185]*Id.* at 375.

[186]*Supra* note 183.

[187]In other words, injustice to the moving party and lack of prejudice to the opposing party become largely irrelevant factors.

[188]*Johnston v. Commissioner*, 122 T.C. 124, *Doc 2004-2908, 2004 TNT 29-13* (2004).

[189]A qualified offer is a settlement offer made by the taxpayer, and denominated as such, any time after the 30-day letter is issued and up to 30 days before the case is first set for trial. Generally, if the amount of the offer (the proposed liability, exclusive of interest) is equal to or greater than the amount ultimately adjudicated, the taxpayer is deemed the prevailing party for purposes of determining whether he is eligible for an award of attorney fees. *See* sections 7430(c) and (g).

[190]*Cinema '84 v. Commissioner,* 122 T.C. 264, *Doc 2004-6456, 2004 TNT 57-15* (2004). *But see Michaels v. Commissioner*, 144 F.3d 495, *Doc 98-15732, 98 TNT 96-23* (7th Cir. 1998) (holding that Tax Court may correct clerical error even after decision is final).

[191]*See* F. R. Civ. Proc. 60; R.P.C.F.C. 60.

[192]The grounds are (1) clerical error; (2) mistake; (3) inadvertence; (4) surprise; (5) excusable neglect; (6) newly discovered evidence that by due diligence could not have been discovered in time to move for a new trial; (7) fraud; (8) misrepresentation; or (9) other misconduct of an adverse party. *Id.*

[193]*See Smith*, 123 T.C. 15, *Doc 2004-14410, 2004 TNT 135-18* (2004). Prior opinions had sometimes cited a lack of general equitable powers on the part of the Tax Court and its predecessors (contrasted with Article III courts) as a basis for concluding

(Footnote continued on next page.)

Commissioner[194] illustrates the draconian consequences that can befall a litigant. There the parties submitted a stipulated decision indicating that, despite a deficiency, the taxpayer had a substantial overpayment for the year at issue. The stipulated overpayment did not take into account assessed interest on the deficiency, a fact of which both parties were evidently aware. After the decision was entered and became final, the taxpayer asserted for the first time that the IRS could not reduce the overpayment by the underpayment interest. In a fully reviewed opinion with five dissents, the Tax Court agreed. It decided that in computing the overpayment, the IRS should have subtracted the assessed, but unpaid, interest. The court also held that, under its jurisprudence, the error did not provide a cognizable ground for setting aside the decision, even though the taxpayer concededly received a windfall.

3. Effect of settlement. A stipulated decision that has become final (and for which no grounds for modification exists) is generally conclusive of the taxpayer's liability for tax, additions to tax, additional amounts, and penalties, or his right to an overpayment, or both, for the year in dispute by reason of claim preclusion (or *res judicata*, as the principle is otherwise known).[195] That judicial doctrine holds that a decision by a court of competent jurisdiction on the merits binds a party not only with respect to every claim presented by it in the case but also with respect to every claim it could have presented.[196] The rule is conducive of judicial economy and discourages piecemeal litigation. In *Estate of Krueger*,[197] the Tax Court held that the doctrine applies not only to a decision on the merits, but also to a stipulated decision. In *Sunnen*,[198] the Supreme Court held that each tax year presents a separate cause of action, or claim, for purposes of claim preclusion.

In contrast, a stipulated decision is not conclusive of the tax treatment of any specific item for subsequent years.[199] That is because a stipulated decision, unlike an actual adjudication, does not require the trial court to consider and decide the issues on the merits.[200] The Supreme Court so held in *International Building Co.*[201] The IRS was permitted in that case to challenge the taxpayer's adjusted basis in an office building and related depreciation deductions even though, in an earlier year involving the same issue, the parties had filed a stipulated decision with the Tax Court stating that no deficiency was due. The Court noted that there had been no adjudication on the merits for the prior year.

B. Other Venues

1. Settlement authority. Authority to represent the interests of the commissioner in civil tax litigation (for example, refund and collection actions) in the other tax forums resides in the Tax Division.[202] Like IRS counsel, the Tax Division will settle cases when appropriate. However, it will normally defer settlement discussions until after discovery (which is frequently more extensive than what IRS counsel may pursue under the Tax Court's procedural rules) has been concluded.

Generally, the Tax Division trial attorney is responsible for managing the case and meeting and negotiating with the taxpayer or his representative. Like his IRS counterpart, the trial attorney has significant flexibility in carrying on settlement negotiations but lacks settlement authority. That begins at the level of the assistant section chiefs in the various civil trial sections and Court of Federal Claims section.[203]

It is expected that the trial attorney will support settlement recommendations in writing.[204] Also, the trial attorney ordinarily is required to solicit the views of IRS counsel on any pending settlement offer made by the taxpayer.[205] (In other words, the offer is vetted by two agencies.)

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that the court was without power to modify its final decisions. *See, e.g., Drobny v. Commissioner,* 113 F.3d 670, *Doc 97-12476, 97 TNT 87-17* (7th Cir. 1997); *Billingsley v. Commissioner*, 868 F.2d 1081 (9th Cir. 1989); *Abeles v. Commissioner*, 90 T.C. 103 (1988). However, in recent years, some appeals courts have held that the Tax Court has general equitable powers similar to those of the federal district courts. *See Smith*, 123 T.C. at 54-55 (Laro, J., concurring) and the cases there cited.

[194]*Supra* note 193.

[195]The code provides exceptions, however. For example, (1) the taxpayer may still be held liable for additional tax attributable to TEFRA partnership items, *see* sections 6213(h) and 6230(a)(1); (2) the IRS is not prohibited from asserting fraud after the fact, section 6212(c), *but see Zakim v. Commissioner,* 91 T.C. 1001 (1988), *rev'd* 887 F.2d 455 (3d Cir. 1989) (holding that doctrine of claim preclusion may bar raising of fraud issue when IRS had adequate opportunity to raise issue in pending case); and (3) the taxpayer is not barred from carrying back later-year attributes to the decision year. Sections 6511(d)(2)(b) and (d)(4)(B).

[196]*Commissioner v. Sunnen*, 333 U.S. 591 (1948).

[197]48 T.C. 824 (1967).

[198]*Supra* note 196.

[199]A stipulation of settled issues similarly lacks conclusiveness beyond the confines of the case.

[200]In contrast, under the judicial doctrine of issue preclusion (also referred to as "collateral estoppel," a judicial opinion may have preclusive effect in subsequent years on issues that were actually presented to, considered, and decided by the court. The Tax Court has held that three conditions must be met to apply the doctrine: (1) the issues presented in the subsequent litigation are in substance the same as those in the first case; (2) the controlling facts or legal principles have not changed significantly since the first judgment; and (3) no other special circumstances warrant an exception to the normal rules of preclusion. *See Meier v. Commissioner*, 91 T.C. 273 (1988) (citing *Montana v. United States*, 440 U.S. 147, 153-54 (1979)).

[201]345 U.S. 502 (1952).

[202]28 C.F.R. 0.70.

[203]*See generally Tax Division Settlement Reference Manual* (the *Reference Manual*), section II. It is notable that, unlike the IRS, the Tax Division has a special office — the Office of Review — that must consider and approve settlement proposals in higher-dollar disputes.

[204]Unlike IRS counsel, however, he will, as a rule, insist that any settlement proposal by the taxpayer be put in writing.

[205]*Reference Manual*, section III, para. G. However, the attorney is not required to do so in cases designated by the IRS as

(Footnote continued on next page.)

2. Settlement documentation. The practice of the Tax Division in settled refund cases is to seek an agreed or stipulated order of dismissal with prejudice.[206] In a collection action against the taxpayer, the settlement is normally reflected in an agreed order or judgment setting forth the amount, if any, due from the taxpayer for the year in dispute.

3. Effect of settlement. An agreed judgment as to the taxpayer's liability for the year will be given preclusive effect for purposes of claim preclusion. An agreed order of dismissal in a settled refund case has been treated similarly.[207] As previously noted, agreed dollar-judgments are without issue-specific preclusive effect for later years. As also indicated, relief from a final judgment is available in some circumstances.

III. Practical Considerations

Against the backdrop of the foregoing discussion, a number of fundamental practical and strategic observations regarding the procedural aspects of settlement are now possible. It may be said, in general, that each level of the dispute resolution process features its own unique attractions and limitations in terms of time, cost, risk, efficiency, and finality. Those factors, along with a multitude of others (substantive, evidentiary, interpersonal, and so on), inform the dynamics of the settlement process in tax cases.

The typical Exam settlement, as we have seen, has the distinct and not insubstantial advantage of conserving the time, energy, and resources of both sides. Still, it must not be overlooked that (outside of TEFRA) the potential for additional tax liability ordinarily will not be fully eliminated until the assessment period closes — a disadvantage for the taxpayer if the return presents other potential, material issues. Also, in the absence of a special procedure such as AIR or fast-track, litigation risks will not forge the outcome.

The Appeals settlement redresses several of those concerns. Of chief importance, the parties can negotiate a resolution that weighs the relative risks — substantive, evidentiary, and so on — to each side if the dispute is not resolved by agreement. Post-Appeals mediation, if appropriate, can help clarify those risks. Also, the settlement (at least if documented with an AD-series form) comes closer to the objective of finality regarding the taxpayer's liability for the year. On the minus side, finality may prove a detriment. An Exam settlement generally will not prevent the taxpayer from later filing a refund claim for the year if the limitations period on refunds remains open. In contrast, an AD settlement, as previously discussed, may have just such a prohibitory effect in various jurisdictions, thereby foreclosing refund opportunities.[208] Another shortcoming of proceeding to Appeals in nondocketed status in a deficiency case is the risk that new issues will be raised, thereby expanding, rather than resolving, the dispute.[209]

Taking the case to court in appropriate circumstances can have the salutary effect of signaling one's resolve. That, along with the distinct possibility that the government's trial attorney will be more acutely aware of the trial risks than an Appeals officer, can inure to the taxpayer's benefit in the quest to negotiate an optimally favorable settlement. Settlement at that level (at least in Tax Court) generally also has the advantage of finality regarding the taxpayer's liability for the year, ordinarily foreclosing further assessments. Again, however, finality may prove problematic if the taxpayer made a mistake. In the Tax Court, at least, "final" basically means final. And there are additional reasons for concern in the docketed setting. First, the government's trial attorney (unlike an Appeals officer) may not be settlement-minded. Second, settlement generally will not be open for discussion until the taxpayer has already expended a great deal of time, effort, and money on trial preparation. Third, a new and potentially unpredictable variable — the court — will be introduced into the settlement mix. Fourth, confidentiality and privacy may be compromised. And finally, care must be taken that words and actions are not misconstrued to create a "settlement" when one is unintended and vice versa.

Settlement of the tax liability, whether at the administrative level or on the courthouse steps, will not, in itself, bring certainty to the proper tax treatment of recurring or rollover items. The Form 906 closing agreement offers a solution to that problem. For practical purposes, the agreement is conclusive. The challenge is in persuading the government to enter into a closing agreement in the particular case. Also of primary concern is that contract

"settlement option" cases. Those typically are matters that are either factual or involve nonrecurring legal issues. *Id.* at section II, para. L.

[206] *Id.*

[207] *See In re: West Texas Marketing Co.*, 13 F.3d 497, *Doc 94-1327, 94 TNT 22-19* (5th Cir. 1994). It has been held, however, that the doctrine of claim preclusion does not prohibit the IRS from asserting a deficiency for a year for which a final order or judgment was earlier entered on the merits in non-Tax Court refund litigation. *See Hemmings v. Commissioner*, 104 T.C. 221, *Doc 95-1786, 95 TNT 25-13* (1995), and the cases there cited (holding that IRS claim for deficiency was not a matter for which a counterclaim was required to be filed in a prior refund suit and, therefore, was not subject to claim preclusion). It is unclear whether the *Hemmings* result would differ if the order in the earlier case was entered by agreement of the parties and was with prejudice.

[208] If the specific issues for which a refund may be sought played no role in the settlement, consideration should be given to requesting that Appeals agree to modify the AD form to reserve those issues. *See* IRM 8.8.1.2.2.

[209] Appeals' general policy is to avoid raising new issues. *See* IRS Policy Statement P-8-49. Nonetheless, Appeals reserves the right to raise a new issue when the grounds for doing so are substantial (possess real merit) and the potential tax effect is material (has real importance). IRM 8.6.1.4.2.4. If Appeals raises a new issue in nondocketed status, the burden of proof on that issue rests with the taxpayer in any ensuing Tax Court litigation. In contrast, if the IRS raises the issue after the case is docketed in Tax Court, the burden of production rests with the IRS, *see* T.C. Rule 142(a) (imposing burden on commissioner as to new matters), and, for that reason, a new issue is less likely to be raised at that juncture.

law principles apply to the agreement's formation, interpretation, and enforcement. That makes caution absolutely imperative. Drafting must be clear and precise (as with any contractual agreement), and all terms must be spelled out. Courts, as we have seen, will not come to the aid of the taxpayer by inferring additional terms. Nor will they rescue either party from an inadvertent mistake.

The same warning applies to settlements in the TEFRA partnership setting. It must be kept in mind that the settlement agreement is ordinarily final and conclusive, at least as to the specified partnership items. It is true that the last chapter has yet to be written as to whether the agreement forecloses further action by the partner and whether and the extent to which the partner may obtain judicial relief from the agreement. Even so, relying on uncertainty in the law as a procedural planning strategy is risky at best.

A final comment on the procedural aspects of the settlement process — specifically regarding settlement authority — is appropriate. The significance of settlement authority (and the reason for its discussion above) lies in agency principles. As a general rule, one person may be bound by the actions of another person if the second person has express, implied, or apparent authority to act on the first person's behalf. What's more, even if the second person has no such authority, the first person may still be bound if he ratifies (that is, adopts) the second person's actions. In a tax dispute, that means that a taxpayer can be saddled with an unwanted settlement at the hands of another person if he fails to proceed with due caution. A recent case provides a vivid illustration. In *Trans World Travel v. Commissioner*,[210] the taxpayer, a corporation, entrusted the handling of all its taxes to its return preparer. The preparer was not an attorney, accountant, or enrolled agent. Nor was he authorized to practice before the Tax Court. Nonetheless, and without express authorization, he prepared, signed, and filed a Tax Court petition on the corporation's behalf. During the pendency of the Tax Court case, the corporate officer-shareholders, who knew little about taxes, unquestioningly signed whatever papers the preparer presented to them. Those included a stipulated decision acknowledging the corporation's liability for more than $400,000 in tax and penalties, which the preparer falsely represented would be reimbursed or refunded. The Tax Court subsequently declined to vacate the decision. It rejected the corporation's assertion that the preparer acted without authority in filing the petition, finding implied authority in light of the officers' routinely referring tax matters to him. The court also concluded that even if the preparer lacked authority, the corporation ratified his actions. The court based this conclusion on the fact that (1) the officers would have understood that a court case was pending if they had studied the correspondence sent to the corporation by the court before passing it along to the preparer; and (2) they never asked questions. In short, the officers placed their imprimatur on the preparer's actions through their willful neglect, and the corporation had to live with the consequences.[211]

In contrast, similar principles do not apply to the government, which is also a reason for proceeding with caution. In *Becker Holding Corp. v. Commissioner*,[212] for instance, the taxpayer sought to hold the IRS to a written settlement offer made by an Appeals officer. Shortly after the offer was made, the IRS abruptly and unexpectedly sent a deficiency notice asserting substantially more tax. The Tax Court declined to find that a settlement had been entered into, noting that the Appeals officer did not have settlement authority and that his supervisor, who did, had not given her approval. The court admonished:

> It has long been held that "persons dealing with an agent of the government must take notice of the limitations of his authority," *Bornstein v. United States*, 345 F.2d 558, 562 (Ct. Cl. 1965); see *Graff v. Commissioner*, 74 T.C. 743, 762 (1980), affd. per curiam 673 F.2d 784 (5th Cir. 1982); *Midwest Motor Express, Inc. v. Commissioner*, 27 T.C. 167, 182 (1956), affd. 251 F.2d 405 (8th Cir. 1958). Petitioner had the responsibility to determine the extent of [the Appeals officer's] authority. See *Boulez v. Commissioner*, 76 T.C. 209, 214 (1981), affd. 810 F.2d 209 (D.C. Cir. 1987).
>
> Further, the Commissioner is not bound by an apparent settlement where an agent is without authority to compromise a taxpayer's tax liability. *Botany Worsted Mills v. United States*, 278 U.S. 282, 288-289 (1929); *Klein v. Commissioner*, 899 F.2d 1149, 1153 (11th Cir. 1990); *Reimer v. United States*, 441 F.2d 1129, 1130 (5th Cir. 1971); *Gardner v. Commissioner*, *supra* at 479.

Becker's practical lesson is clear: In seeking to resolve a tax controversy at any level, care must be taken to ascertain which institutional approvals are required and which individuals have the actual authority to give those approvals. It should not be assumed that the dispute is resolved in advance of receipt of those approvals. Any such assumption can be a prescription for calamity.

IV. Conclusion

At a time when a rising tide of tax controversies can be anticipated in the wake of increasingly vigorous IRS enforcement efforts, familiarity with settlement procedures and principles and their importance is vital. Lack of sensitivity to the procedural nuances of settlement practice in tax cases invites needless misunderstandings and disappointment.

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[210]T.C. Memo. 2001-6, *Doc 2001-1791, 2001 TNT 12-26*.

[211]For a similar result in the TEFRA partnership context, see *Mishawaka Properties Co.*, 100 T.C. 353, *Doc 93-4609, 93 TNT 82-13* (1993) (holding that partners implicitly ratified Tax Court petition filed by promoter without their authorization; partners permitted promoter to act on their behalf and were aware of Tax Court case; partners' motion to dismiss for lack of jurisdiction denied). In contrast, the Tax Court recently vacated a stipulated decision when the taxpayers established that their former counsel had "settled" the case without their knowledge, despite his being directed that any proposed settlement required their express approval. *Keil v. Commissioner*, T.C. Memo. 2005-76, *Doc 2005-7225, 2005 TNT 67-10*.

[212]T.C. Memo. 2004-58, *Doc 2004-5138, 2004 TNT 48-17*.