

# Appeals Judicial Approach and Culture Project

*By James R. Gadwood\**

James Gadwood examines the Appeals Judicial Approach and Culture Project and warns that as a result of the project, Appeals will return a case to the examination function if a taxpayer presents a “new issue” or “new information” during the Appeals process.



**T**he Appeals Judicial Approach and Culture (AJAC) Project aimed to return the IRS Office of Appeals to a “more quasi-judicial approach in the way it handles cases.”<sup>1</sup> In that vein, the AJAC Project highlighted—and in some ways reestablished—the distinction between the IRS examination function and the Appeals function. Whereas the former fulfills a fact-finding and investigatory function, the latter serves as independent arbiter, weighing the hazards of litigation based on evidence gathered by the examination function.

The IRS announced the AJAC Project nearly three years ago.<sup>2</sup> Since then Appeals has implemented the project by issuing hundreds of pages of guidance. That guidance was effective immediately and has been incorporated into the Internal Revenue Manual (IRM).<sup>3</sup> In fact, so much integration has occurred that Appeals is trying to phase out the term AJAC altogether and instead refer simply to “Appeals policy.”<sup>4</sup>

Notwithstanding that integration, many practitioners may not yet have been to Appeals in the post-AJAC world. With that in mind, this article provides a refresher on some key changes that AJAC implemented with respect to income tax cases that originate from the IRS examination function.

## I. Timing Requirements

To ensure that Appeals has sufficient time to fulfill its role as independent arbiter, the AJAC Project imposed new timing requirements on taxpayers seeking to take advantage of the Appeals process. First, there must be at least 365 days remaining

**JAMES R. GADWOOD** is a Tax Associate at Sullivan & Cromwell LLP.

on the assessment statute of limitations before Appeals will accept a nondocketed case.<sup>5</sup> Second, Appeals will return a case to the examination function for consideration of new issues or information raised by a taxpayer (discussed in more detail in Part III below) only if there are at least 210 days remaining on the assessment statute of limitations.<sup>6</sup> Third, Appeals will accept a case that Appeals previously returned to the examination function only if there are at least 180 days remaining on the assessment statute of limitations.<sup>7</sup>

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These time periods do not apply to refund claims and other cases that do not involve a proposed deficiency.<sup>8</sup> However, taxpayers seeking an Appeals conference in a deficiency case should be prepared to extend the statute of limitations when necessary to satisfy the foregoing timing requirements.

## II. New or Agreed-Upon Issues

Appeals used to have discretion to raise new issues and reopen agreed issues if there were substantial grounds for doing so and the potential effect on tax liability was material.<sup>9</sup> This rule made some taxpayers fear that they might get a worse result at Appeals than at the examination level. The hazy standard that Appeals had to satisfy before exercising its discretion served to further increase uncertainty in this area.

Following the AJAC Project, however, Appeals will no longer raise new issues or reopen agreed issues.<sup>10</sup> This black-and-white rule provides welcome certainty for taxpayers. The rule also fosters one of the AJAC Project's guiding principles: Appeals is not a continuation or extension of the examination process.<sup>11</sup>

For purposes of the post-AJAC rule, a new issue is a matter not raised during an examination.<sup>12</sup> A new issue does not include a new theory, alternative argument or change in computation.<sup>13</sup> Similarly, discussing new or additional cases or other authorities (*e.g.*, revenue rulings or revenue procedures) that support a theory or argument previously presented does not constitute consideration of a new issue.<sup>14</sup>

## III. Returning Cases to the Examination Function

Before the AJAC Project, Appeals could return a case to the examination function if (1) Appeals needed substantial additional information to resolve an important issue, or (2) there were significant unresolved factual variances between the examination report and the taxpayer's protest.<sup>15</sup> After AJAC, however, Appeals will no longer return cases to the examination function for further development.<sup>16</sup> Rather, Appeals will attempt to settle underdeveloped cases based on the factual hazards.<sup>17</sup>

Although Appeals will no longer return underdeveloped cases to the examination function, Appeals will return a case if the taxpayer (1) raises a new issue, or (2) provides new information during the Appeals process.<sup>18</sup> This policy ensures that the examination function rather than Appeals performs the IRS's fact-finding and investigatory function. In contrast, if a taxpayer raises a new theory or alternative legal argument, then Appeals will retain jurisdiction over the case but send the taxpayer's new theory or argument to the original examination team for review and comment.<sup>19</sup>

### New Issues or Information

A new issue is a matter not raised during the examination.<sup>20</sup> However, a new theory or alternative argument is not a new issue, nor is a change in computation.<sup>21</sup> Appeals will give "full, fair, and impartial consideration to the merits of each new issue a taxpayer raises once the originating function has had an opportunity to examine the issue."<sup>22</sup> In other words, while Appeals will no longer raise a new issue, a taxpayer may still do so during the Appeals process. However, if that happens, Appeals will return the case to the examination function.

New information includes any item or document related to a disputed issue that the taxpayer did not previously share with the examiner and, in Appeals' judgment, "merits additional analysis or investigative action by Examination."<sup>23</sup> Additional analysis means anything that is not self-evident or involves voluminous information.<sup>24</sup> Investigative action means actions required for fact finding, to make inquiries or to verify the authenticity of an item.<sup>25</sup>

If a taxpayer raises a new issue or information, Appeals will release jurisdiction and return the case to the originating function if there will be at least 210 days remaining on the statute of limitations when the originating function receives the case.<sup>26</sup> In contrast, if there would be less than 210 days remaining on the statute of limitations, Appeals will solicit a consent to extend the statute of limitations.<sup>27</sup>

Appeals will ensure that the consent allows sufficient time for the originating function to complete its actions on the new issue and potentially return the case to Appeals.<sup>28</sup> If the taxpayer will not sign the consent, Appeals will not consider the new issue and will follow its procedures to protect the statute of limitations (including preparing a notice of deficiency).<sup>29</sup>

## New Theory or Alternative Legal Argument

If a taxpayer raises a new theory or alternative legal argument at Appeals, Appeals will retain jurisdiction but send the taxpayer's new theory or argument to the original examination group for review and comment.<sup>30</sup> Because Appeals retains jurisdiction, there is no focus on a minimum number of days remaining on the statute of limitations when Appeals refers the taxpayer's new theory or argument to the original examination group. The original examination group will have at least 45 days for written review and comment.<sup>31</sup>

## Intentional Delay

Notwithstanding the general rules that apply when a taxpayer raises new issues or information, Appeals will not return a case to the originating function if, in Appeals' judgment, the taxpayer unreasonably delayed the process by intentionally submitting new information or raising new issues multiple times to impede the process.<sup>32</sup> In such a case, Appeals must make a determination based on the factual hazards.<sup>33</sup>

## IV. Implications

As a result of the AJAC Project, taxpayers can no longer hold back information during the examination phase and present that information for the first time at Appeals. While in the past some taxpayers may have intentionally taken that approach to obtain a strategic advantage, others may have done so for more benign reasons. For example, sometimes a taxpayer is simply unable to obtain (or ensure completion of) an expert witness report or valuation study before an examination team closes a case to Appeals. Taxpayers used to take comfort from the fact that they could nevertheless present their entire case—new facts and all—as part of the Appeals process. However, following the AJAC Project, Appeals will return the case to the examination function if the report or study falls within the definition of “new information.”

A number of adverse consequences arise when Appeals returns a case to the examination function. First, case

resolution will almost certainly be delayed. The examination team may have moved on to other cases or issues and so may be unable to consider the new issues or information immediately. Moreover, addressing the returned case might divert time and attention away from other issues that the taxpayer would rather the examination team focus on, such as unresolved refund claims for a subsequent audit cycle.

Second, underpayment interest will continue to accrue.<sup>34</sup> Importantly, taxpayers typically receive a revenue agent report before going to Appeals. And for large corporate underpayments, that means that the applicable underpayment interest rate has increased by two percentage points (commonly referred to as “hot interest”).<sup>35</sup> Any delay that results from Appeals returning a case to the examination function will, therefore, increase the period during which interest accrues at a higher statutory rate.

## V. Conclusion

Taxpayers who find themselves heading to Appeals for the first time since the AJAC Project should review the AJAC guidance and understand the revised procedural landscape. New timing requirements and rules for when Appeals will return a case to the examination function are also important to consider during the examination phase. To avoid delays and additional interest accruals that could result if Appeals returns a case to the examination function, taxpayers should present all relevant facts and raise all relevant issues before the examination team closes a case to Appeals.

### ENDNOTES

- \* This article expresses the author's personal views.
- <sup>1</sup> E.g., Memorandum from Susan L. Latham, IRS Office of Appeals, to Appeals Employees (Control No. AP-08-0713-03) (July 18, 2013).
  - <sup>2</sup> Jeremiah Coder, *Appeals Ex Parte Rules Are No Impediment to Legal Advice*, TAX NOTES TODAY, 2012 TNT 202-03 (Oct. 18, 2012) (quoting Christopher Wagner, former Chief, IRS Office of Appeals).
  - <sup>3</sup> The IRM does not have the force of law and is not binding on the IRS. See, e.g., *H.J. Marks*, DC-DC, 91-2 ustrc ¶150,521, 947 F2d 983, 986 n.1.
  - <sup>4</sup> William Hoffman, *ABA Meeting: Changes Coming to IRS Exams*, TAX NOTES TODAY, 2015 TNT 90-5 (May 11, 2015) (quoting Nikole Flax, Acting Deputy Chief, IRS Office of Appeals).
  - <sup>5</sup> IRM pt. 8.2.1.4(1) (Aug. 11, 2015). Appeals requires only 270 days remaining on the statute of limitations when Appeals receives an estate tax case or excessive refund claim under Code Sec. 6206. *Id.*
  - <sup>6</sup> IRM pt. 8.6.1.6.4(3) (June 25, 2015) (taxpayer raises new issue); IRM pt. 8.6.1.6.5(4) (June 25, 2015) (taxpayer provides new information).
  - <sup>7</sup> IRM pt. 8.2.1.4(1) (Aug. 11, 2015).
  - <sup>8</sup> IRM pt. 8.7.7.2.1(2) (Oct. 16, 2014).
  - <sup>9</sup> IRM pt. 1.2.17.1.2 (Jan. 5, 2007).
  - <sup>10</sup> IRM pt. 1.2.17.1.2 (Aug. 13, 2014). This policy does not apply to new issues raised by taxpayers. Rather, see Part III for the rules that apply when a taxpayer raises a new issue.
  - <sup>11</sup> IRM pt. 8.6.1.6.2(1) (Nov. 14, 2013).
  - <sup>12</sup> IRM pt. 8.6.1.6.1(2) (Nov. 14, 2013).

<sup>13</sup> IRM pt. 8.6.1.6.1(3) (Nov. 14, 2013).

<sup>14</sup> IRM pt. 8.6.1.6.2(4) (Nov. 14, 2013).

<sup>15</sup> IRM pt. 8.2.1.6(1) (Oct. 18, 2007).

<sup>16</sup> IRM pt. 8.2.1.5(1) (Aug. 11, 2015).

<sup>17</sup> IRM pt. 8.2.1.4(3) (Aug. 11, 2015).

<sup>18</sup> IRM pt. 8.2.1.5(2)(I) & (J) (Aug. 11, 2015); *see also* IRM pt. 8.6.1.6.4(3) (June 25, 2015) (taxpayer raises new issue); IRM pt. 8.6.1.6.5(4) (June 25, 2015) (taxpayer provides new information).

<sup>19</sup> IRM pt. 8.6.1.6.6(1) (June 25, 2015).

<sup>20</sup> IRM pt. 8.6.1.6.1(2) (Nov. 14, 2013).

<sup>21</sup> IRM pt. 8.6.1.6.1(3) (Nov. 14, 2013).

<sup>22</sup> IRM pt. 8.6.1.6.4(1) (June 25, 2015).

<sup>23</sup> IRM pt. 8.6.1.6.5(1) (June 25, 2015).

<sup>24</sup> IRM pt. 8.6.1.6.5(1)(A) (June 25, 2015).

<sup>25</sup> IRM pt. 8.6.1.6.5(1)(B) (June 25, 2015).

<sup>26</sup> IRM pt. 8.6.1.6.4(3) (June 25, 2015); IRM pt. 8.6.1.6.5(4) (June 25, 2015).

<sup>27</sup> IRM pt. 8.6.1.6.4(2) (June 25, 2015); IRM pt. 8.6.1.6.5(3) (June 25, 2015).

<sup>28</sup> IRM pt. 8.6.1.6.4(2) (June 25, 2015); IRM pt. 8.6.1.6.5(3) (June 25, 2015).

<sup>29</sup> IRM pt. 8.6.1.6.4(2) (June 25, 2015); IRM pt. 8.6.1.6.5(3) (June 25, 2015).

<sup>30</sup> IRM pt. 8.6.1.6.6(1) (June 25, 2015).

<sup>31</sup> IRM pt. 8.6.1.6.6(3) (June 25, 2015).

<sup>32</sup> IRM pt. 8.6.1.6.5(4) (June 25, 2015).

<sup>33</sup> *Id.*

<sup>34</sup> *See* Code Sec. 6601(a).

<sup>35</sup> *See* Code Sec. 6621(c).

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