

# **IRS Audits: Faking an appeal to get information**

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## **Introduction**

A recently issued revenue procedure, Rev. Proc. 99-28, 1999-29 IRB 1, appears to provide taxpayer representatives with a method of flushing out the auditor's position on particular issues during the course of an audit, rather than waiting until completion of the audit and the receipt of the 30-day letter. Of course, that is not the purpose of the new revenue procedure, but tax practitioners need to take advantage of all possible efficient methods of advocacy when representing a client before the Internal Revenue Service, whether or not the IRS intended to provide taxpayers with those methods. Taxpayers and their representatives can also use Rev. Proc. 99-28 for its intended purposes. In any event, taxpayers and their representatives need to understand the procedures and dynamics of the early referral appeals program to take advantage of the unintended or intended opportunities.

A typical federal tax audit begins with an examination of the taxpayer's records by the IRS Examination Division of a local District Director's Office. An audit usually concludes in one of four ways: no change, fully agreed, partially agreed, or unagreed. No change and agreed cases go no further. Partially agreed and unagreed matters can be administratively resolved by the IRS Office of Appeals if the Examination Division issues a "30-day" letter and the taxpayer timely files an Appeals protest. Up until a few years ago, the IRS drew a bright line between the jurisdiction of its audit division and the jurisdiction of the Office of Appeals. Under the old system, the Office of Appeals did not have jurisdiction over any audit issues until the entire examination had been completed and a 30-day letter had been issued.

The strict division of jurisdiction was relaxed when the IRS administratively adopted an Appeals early referral procedure for coordinated examination program ("CEP") cases. The CEP early referral program was design to allow the Office of Appeals to resolve "fully developed" issues pending in an examination while the audit division continued to examine the "undeveloped" issues. The early referral program for CEP cases allowed the taxpayer to pursue settlement of fully developed issues with the Office of Appeals without waiting for the audit division to complete its examination of all of the issues.

The Internal Revenue Service Restructuring and Reform Act of 1998 enacted IRC §7123(a) which directs the IRS to:

prescribe procedures by which any taxpayer may request early referral of 1 or more unresolved issues from the examination or collection division to the Internal Revenue Service Office of Appeals.

On July 10, 1999 the IRS issued Rev. Proc. 99-28 setting forth its procedures for the general early referral program under IRC §7123. Rev. Proc. 90-28 contains general procedures for early referral of all audit issues. It also contains a list of limited issues that will be considered for early referral with regard to audit issues related to an involuntary change in method of accounting, employment taxes, employee plans, or exempt organizations.

### **Summary of the Early Referral Appeals Program**

The early referral program is entirely optional. An early referral cannot be made unless requested by the taxpayer, and an early referral will not be made unless the District Director agrees to participate. There is no formal taxpayer appeal if the early referral request is denied in whole or in part, however, the taxpayer can request a conference to discuss a denial with the supervisor of the case/group manager who denied the early referral request.

Rev. Proc. 99-28 states that a taxpayer can request an early referral for "any developed, unagreed issue under the jurisdiction of the District Director arising from an audit." Rev. Proc. 99-28, however, also states that early referral request will only be granted for issues that:

- (1) if resolved, can reasonably be expected to result in a quicker resolution of the entire case;
- (2) are fully developed; and
- (3) are part of a case where the remaining issues are not expected to be completed before Appeals could resolve the early referral issue.

Rev. Proc. 99-28 also contains a list of situations for which a request of an early referral will be denied, including matters

- (1) with respect to which a 30-day letter has been issued.
- (2) that are designated for litigation by the Office of Chief Counsel;
- (3) for which the taxpayer has filed a request for Competent Authority assistance, or issues for which the taxpayer intends to seek Competent Authority assistance.
- (4) that involve a "whipsaw" transaction for the IRS.

A request for early referral must be submitted in writing by the taxpayer to the case/group manager. The request must:

- (1) identify the taxpayer (and, where applicable, all related persons involved in the issues) and the tax periods to which those issues relate;
- (2) state each issue for which early referral is requested;

- (3) describe the taxpayer's position with regard to the relevant early referral issues;
- (4) contain a brief discussion of the material facts and an analysis of the facts and law as they apply to each early referral issue; and
- (5) include a declaration, signed by any person currently authorized to sign the taxpayer's federal income tax returns, in the following form

Under penalties of perjury, I declare that I have examined this request [or submission], including accompanying documents, and to the best of my knowledge and belief, the facts presented are true, correct, and complete.

The IRS will try to decide whether to reject or accept the early referral request within 14 days of receiving the request. The District will complete a Form 5701, Notice of Proposed Adjustment, or an equivalent form (the Notification Form) for each issue approved for early referral. The District will send the Notification Form to the taxpayer within 30 days from the date the early referral request was accepted. The Notification Form will describe the issue and explain the District's proposed adjustment. The issuance of the Notification Form for the early referral issue is not treated as the first letter of proposed deficiency for purposes of computing increased interest under section 6621(c), or for the award of administrative costs under section 7430(c).

After receipt of the notification, the taxpayer can simply ignore the follow-up procedures and go back to the audit knowing more about the government's position on the issues than could probably be derived from informal discourse with the auditor. The request for early referral and the government's delivery of the Notification Form do not alter the taxpayer's normal appeal rights. If, however, the taxpayer takes the next step in the early referral request process, then rights to a subsequent appeal will be affected.

If the taxpayer wants to continue the early referral process, then the taxpayer must respond in writing to each of the District's proposed adjustments set forth in the Notification Form. The response must contain an explanation of the taxpayer's position regarding the issues. The response must be submitted to the case/group manager within 30 days (unless extended by the case/group manager) from the date that the proposed adjustment (the Notification Form) is sent to the taxpayer. The response must include a perjury declaration, signed by any person currently authorized to sign the taxpayer's federal income tax returns. If a response is not received for any issue within the time provided, the taxpayer's early referral request will be considered withdrawn regarding that particular issue without prejudice to the taxpayer's right to an administrative appeal at a later date.

After the taxpayer has responded to the Notification Form, the District will send the early referral file to Appeals. Appeals will then have jurisdiction over the issues accepted for early referral. All other issues in the case remain in the District's jurisdiction. Closing agreements will be used for issues resolved by Appeals under the early referral program. The closing agreement is used to compute the corrected tax as a partial agreement prior to or concurrently with the resolution of any other issues in the case. If early referral negotiations are unsuccessful taxpayers may request mediation

for the issue, provided the early referral issue meets the requirements for mediation. See Announcement 98-99, 1998-46 I.R.B. 34. If mediation is not requested, Appeals will close the early referral file and return jurisdiction over the issue to the District. Appeals will not reconsider an unagreed early referral issue if the entire case is later protested to Appeals, unless there has been a substantial change in the circumstances regarding the early referral issue.

After Appeals has taken jurisdiction over an early referral request, a withdrawal of the request by the taxpayer will be treated in the same manner as a case closed as unagreed by Appeals. The withdrawal request must be communicated in writing to the Appeals Officer assigned the early referral.

### **Conclusion**

Although the IRS appears to have complied with the dictates of section 7321, the early referral program outlined by Rev. Proc. 99-28 only provides taxpayers with the right to ask for an early referral to Appeals. The Examination Division can unilaterally block an early referral and taxpayers have no efficient method of challenging the Examination Division's decision to decline an early referral request. However, the request for an early referral affords taxpayers an opportunity to formally flush out the auditor's position on issues before completion of the entire audit. That opportunity is one which should not be ignored even if an early appeal request would not otherwise be worth the effort.