Help for Taxpayers: Understanding the Hazards of Litigation in Appeals

By Heather Posey, Esq., & Thomas Fowlkes

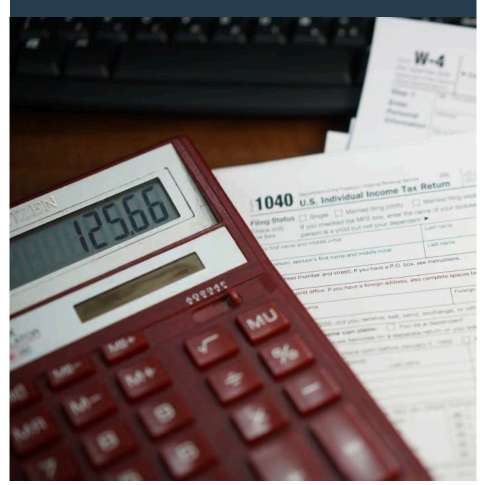
It is a fundamental principle of tax administration that not all Internal Revenue Service determinations are final. This concept is enshrined in the Taxpayer Bill of Rights, which highlights that all taxpayers have the right to appeal an IRS decision in an independent forum.

For taxpayers unhappy with an adverse decision by an IRS employee or business unit, the Appeals process provides a critical avenue for people to get an independent review with the IRS Independent Office of Appeals. And it's a valuable opportunity for taxpayers to challenge the IRS' position without costly and burdensome court proceedings.

Appealing an IRS decision can be a complex task, but it can be worthwhile to taxpayers. Frost Law's team has years of experience dealing with the IRS and Appeals. Taxpayers can reach out for help by contacting Frost Law today at **(410) 497-5947** or by **scheduling a confidential consultation.**

To help taxpayers understand some of the complexities involved with filing an Appeal, here's an overview of several key factors involved in these cases.

Info@AskFrost.com



The Technical Details: What Are the Hazards of Litigation?

Under Internal Revenue Manual ("IRM") 8.6.4.2.5, Appeals Officers are required to maintain an impartial, objective, and quasi-judicial attitude that does not simply seek the best possible result for the government. Central to this quasi-judicial approach inside Appeals is an analysis of the "hazards of litigation." Understanding this concept is vital, as Appeals Officers are directed to consider the hazards of litigation as part of their analysis, as well as the decision regarding whether to sustain the IRS' position or to negotiate a settlement with the taxpayer.

As explained by the IRS in I.R.M. 8.11.1.2.7.5(4), the hazards of litigation are the uncertainties of the outcome of a court's decision in the event of a trial. In essence, the hazards of litigation are the risk each party faces that its position would not be sustained if considered by a court. In evaluating the taxpayer's position, the Appeals Officer must further analyze whether, in lieu of fully sustaining the position of the IRS, the case can be settled. During the Appeals process, the Appeals Officer is directed to determine what hazards both the government and the taxpayer may face during litigation, and Appeals Officers are authorized to offer a settlement in consideration of such hazards.

Under IRS Policy Statement 8-47 (IRM 1.2.1.9.6), Appeals Officers must give serious consideration to any settlement offer that fairly reflects the relative merits of the opposing views in light of the hazards. To do this, IRM 8.6.1.7.2(3) further authorizes Appeals Officers to consider new theories or alternative arguments supporting either position (since courts will likewise analyze new or alternative arguments and case theories), which allows the Office of Appeals to examine the merits of each case similar to a court.

In practice, these litigation prospects are typically divided into two main categories – factual hazards and legal hazards, alongside an occasional third category known as evidentiary hazards:

- Factual hazards involve elements such as the availability of substantiating records, witness credibility, testimony to be presented at trial, disputed valuations, competing expert testimony, and reliance on estimates or reconstructions.
- On the other hand, legal hazards involve conflicting court cases, circuit splits, ambiguous statutes or regulations, new legal arguments, and frequently-changing law. Notably, under IRM 8.11.1.2.7.5, a mere lack of case law is not treated as a hazard.
- Lastly, evidentiary hazards involve elements such as witness credibility and availability, the testimony expected at trial, and the authenticity or admissibility of documents or records.

When a mutual agreement is reached based on these hazards, IRM 8.1.3.5 emphasizes that all aspects of the case must be fully discussed so that all parties understand the underlying issues. The Appeals Officer is required to fully explain the settlement proposal to the taxpayer and the IRS as well as document the decision-making steps in an Appeals Case Memorandum. Per IRM 8.6.2.6.4.2, this requires the Appeals Officer to summarize the identified hazards, weigh the relative strengths and weaknesses, determine the strengths of the opposing positions, and ultimately convert these factors into a concrete percentage or numerical determination.

Factors the Appeals Officer Should Consider

According to the Taxpayer Advocate Service, an independent voice inside the IRS, some hazards that Appeals Officers should consider include:

- Whether the taxpayer has representation or is pro se.
- Whether the case qualifies as a small case in the United States Tax Court, where the amount in dispute is $50,000 or less per year. Small cases are subject to different procedures and relaxed evidentiary rules.
- Prior case precedent on the specific issue, as well as the government's historical track record of victory or loss on that issue.

- The volume of prior case precedent that is available; for example, whether there are multiple established cases or only a few.
- Whether the information and documentation supplied by the taxpayer is credible and accurately supports the underlying facts of the case.
- Whether the taxpayer's position has legal merit and is properly grounded in the law.

Collectively, these factors establish an analytical spectrum. When few or none of these elements favor the taxpayer, the Appeals Officer will likely perceive minimal or negligible hazards of litigation to the IRS, thereby increasing the likelihood that the taxpayer will lose the appeal and the IRS position will be fully sustained. But when several of these factors favor the taxpayer or give rise to substantial uncertainty as to the government’s ability to prevail, the Appeals Officer must consider a settlement proposal in an effort to prevent litigation as well as conserve judicial resources. This scenario can be to the benefit of both the taxpayer and the government.

Factors the Appeals Officer May Not Consider

According to IRM 8.1.1.3.1, Appeals Officers are restricted from considering certain types of arguments when evaluating the hazards of litigation. These can include arguments raised regarding the validity of a Treasury Regulation or the procedural validity of IRS notices or Revenue Procedures published in the Internal Revenue Bulletin (IRB). Some examples of this include whether a regulation, IRB notice, or Revenue Procedure was noncompliant with notice-and-comment requirements regarding the Administrative Procedure Act (APA), is contrary to statute, or exceeds the scope of the statute.

In practice, during an Appeals conference, the Appeals Officer is prohibited from factoring in arguments regarding the validity of regulations or subregulatory guidance when evaluating the hazards of litigation. Despite this, it remains vital to raise any challenges to the validity of a regulation at this stage to ensure the taxpayer’s claims are preserved for potential subsequent court proceedings. Even if an Appeals Officer cannot meaningfully hear this argument, failure to raise it in Appeals may foreclose the ability to raise the same argument during litigation. As an exception, an Appeals Officer may consider these positions if the specific authority has been invalidated by a federal court in a final, unreviewable decision.

Frost Law Can Help Taxpayers With Appeals Cases

This discussion does not cover all of the potential factors to be weighed in an Appeals case. There are many factors relevant to an Appeals Officer’s settlement decision, and each taxpayer’s situation is different.

A meaningful analysis of the hazards of litigation is complex and often requires extensive research. Frost Law can help. Our team understands these nuances, building off years of helping taxpayers navigate the Appeals process. Contact our team today at **(410) 497-5947** or **schedule a confidential consultation**.

More News Articles