Birnam Wood Comes for IRS Appeals

by Elizabeth K. Blickley

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Elizabeth K. Blickley (eblickley@foxrothschild.com) is counsel in the taxation and wealth planning department at Fox Rothschild LLP.

In this article, Blickley criticizes proposed regs meant to implement the Taxpayer First Act, arguing that extensive exceptions in the regulations unduly limit taxpayers' rights to access the IRS Independent Office of Appeals.

In Act 4, Scene 1 of *Macbeth*, the three witches tell Macbeth he will remain king until Birnam Wood comes to Macbeth's castle. Rather than any natural movement, the English army simply chopped down the trees, carried the branches to hide their approach, and defeated Macbeth. In this article, I examine the various approaches the IRS has taken to preclude taxpayers from obtaining guidance, restricting instead of expanding access to Appeals, and ultimately invading Appeals' independence. This coordinated effort culminated in its most recent proposed regulations, which would allow the IRS to ensure that there is no additional access to Appeals and that Appeals simply becomes another part of the IRS's litigation function, rather than trying to get to the correct amount of tax. I encourage all stakeholders to read the comments to the proposed regulations and articles regarding the hearing held on November 29.[1]

On September 13, Treasury issued proposed regulations purporting to implement the Taxpayer First Act.[2] At first glance, a casual reader might not be concerned about the 67 pages of proposed regulations or the 24 listed exceptions preventing taxpayers from having their cases considered by the IRS Independent Office of Appeals. On further review, however, it becomes clear that the proposed regulations serve as an abrogation of the obligations set forth in the TFA, an encroachment on Appeals' mandate of impartiality and independence, and an abdication of the general rule allowing access to Appeals as set forth in the TFA.

The mandate of Appeals is to review the positions of the IRS and the taxpayer, determine the hazards of litigation, and, if appropriate, negotiate a fair settlement. By and large this process works as designed, and both parties walk away satisfied. Over time, however, the IRS has taken the position that more and more litigants and potential litigants should not have access to, and more and more issues should not be addressed by, the only independent forum within Treasury established for reaching fair and reasonable settlements. Against this backdrop, the TFA provided new instructions creating the general rule in favor of access to Appeals, with only narrow and limited exceptions.

The proposed regulations constitute an attempt by the IRS to override congressional language, will, and intent. Rather than expanding

[1]This article was drafted before *Green Valley Investors LLC v. Commissioner*, 159 T.C. No. 5 (Nov. 9, 2022), which struck down Notice 2017-10, 2017-4 IRB 544, and further supports the argument that the IRS's proposal to limit Appeals' review to unreviewable federal court opinions is unreasonable.

[2]*See* REG-125693-19; *see also* Taxpayer First Act (P.L. 116-25).

access to Appeals, the proposed regulations indicate that the IRS intends to maintain the limitations in place before the TFA and expand the definitions of the exceptions to swallow the rule. Litigation asserting that the TFA provides taxpayers with access to Appeals is already pending.[3] Moreover, even cases or issues otherwise designated for litigation provide evidence that Appeals is an important safety valve to ensure taxpayers have the "right to pay no more than the correct amount of tax."[4]

A recent court opinion exemplifies the issue. On October 17, more than seven years after the filing of the petition, and after reversal by the Eleventh Circuit, the Tax Court finally determined the value of a claimed deduction for the donation of a conservation easement to be about $7.8 million, or 75 percent of the amount originally claimed by the petitioner.[5]

After the IRS and Department of Justice spent almost a decade of attorney time (and taxpayer dollars) arguing that the donation had no value and then, later at trial, that the donation had a value of $20,000, the Tax Court held that the IRS was incorrect by orders of magnitude. Valuation cases like this one are exactly the type of case that parties should submit to Appeals for independent review and possible settlement. Instead, the proposed regulations will ensure that the IRS continues to spend, and waste, taxpayer funds in this scorched-earth manner.[6]

Conservation easement cases are just one category designated by the IRS for litigation.[7] This one incredibly broad designation affects thousands of civil cases in which the IRS has not asserted fraud, lack of economic substance, or even the involvement of a promoter. Moreover, the IRS routinely denies deductions in full in many conservation donation cases regardless of whether the donation was of a fee simple or an easement; the donor was an individual or a group; the donee was a 501(c)(3) organization or a subdivision of local government; the transaction was or was not syndicated; an appraisal and a contemporaneous written acknowledgment were attached to the return; the IRS hired its own appraiser during the examination process and determined there is a value; or the property provided habitat for verified endangered species.

Under the proposed regulations, simply claiming the deduction years ago will now result in a taxpayer's becoming ineligible to argue their case before Appeals to try to get to the right amount of tax. The sheer variety and volume of cases caught in this one designation shows that the exceptions are not narrow or reasonable and shows just how vital access and meaningful settlement offers are in this process — the very goal of the TFA and the "right to a fair and just tax system."[8]

Beyond that example, the proposed regulations address five major issues in ways that conflict with the language and intent of the TFA.

Independence

The TFA gave Appeals a new name: IRS Independent Office of Appeals. The addition of the single word "independent" to the title of the office was significant to Congress, and it is significant to taxpayers. Independent is defined as "not subject to the control or influence of another an independent investigation."[9] Given that the full name includes reference to the IRS, Congress understood that the IRS would still house Appeals, but Congress also intended that Appeals would not be subject to the control of the IRS, just as the national taxpayer advocate reports to the commissioner but remains independent. The legislative history provides, in relevant part:

> To foster confidence in the integrity of the IRS and the independence of its administrative proceedings and to encourage voluntary compliance, the

[3] Initial Brief of Appellants, *Rocky Branch Timberlands LLC v. United States*, No. 22-12646 (11th Cir. Oct. 21, 2022), on appeal from No. 1:21-cv-2605-MB (N.D. Ga. 2022); and *Hancock County Land Acquisitions LLC v. United States*, No. 21-12508 (11th Cir. 2022).

[4] *See* Taxpayer Bill of Rights 2.

[5] *Champions Retreat Golf Founders LLC v. Commissioner*, T.C. Memo. 2022-106.

[6] Review of the docket sheets for many conservation easement cases shows that, since the enactment of the Inflation Reduction Act allocating $80 billion for the IRS, the IRS has simply added more attorneys to these cases.

[7] They are, however, far from the only type of case designated for litigation. The designation is incredibly broad and encompasses thousands of cases.

[8] *See* Taxpayer Bill of Rights.

[9] *Black's Law Dictionary* (2019).

> Committee believes it is advisable to codify the role of an independent administrative appeals function within the IRS and provide new guidelines for procedures that the IRS is to follow in the new office. In doing so, the Committee seeks to reassure taxpayers of the independence of the persons providing the administrative review.[10]

The proposed regulations, however, do not provide new guidelines. Instead, they seek to reimpose old guidelines. This misinterpretation of congressional intent, taken together with other IRS actions permitting further encroachment by the Examination Division and the Office of Chief Counsel in Appeals conferences,[11] reveal that the proposed regulations further the IRS goal of hobbling Appeals' independence for any taxpayer fortunate enough to still receive access. Even the national taxpayer advocate noted this problem in her 2022 purple book:

> The expansion of Appeals conferences to routinely involve Counsel and Compliance personnel alters the relationship between taxpayers and Appeals Officers. It makes interactions less negotiation-based and transforms the conference into a more contentious and one-sided proceeding. This approach is also seemingly inconsistent with Congress's intent to "reassure taxpayers of the independence" of Appeals.[12]

Recognizing the IRS's intention to continue both the practice of including the very intransigent personnel that led the taxpayers to seek a conference with Appeals in the first place and the encroachment on Appeals' independence even before these proposed regulations were issued, the national taxpayer advocate asserted that Congress should amend the code to end this practice, proposing a new section 7803(e):

> A taxpayer shall have the right to a conference with the Independent Office of Appeals that does not include personnel from the Office of Chief Counsel or the compliance functions of the Internal Revenue Service unless the taxpayer specifically consents to the participation of those parties in the conference.[13]

The national taxpayer advocate sees the writing on the wall regarding Appeals' independence, and so too should we.

Access to Appeals

As outlined by others,[14] Congress has enacted several statutes in an effort to expand access to Appeals. The courts, however, found that neither the Restructuring and Reform Act of 1998 nor the Taxpayer Bill of Rights provided a guaranteed right to Appeals.[15] Thus, the TFA direction that Appeals "shall be generally available to all taxpayers" expressed the intent of Congress to expand access — the rule, not the exception, would be access to Appeals. The House report states:

> Independent Appeals is intended to perform functions similar to those of the current Appeals. Independent Appeals is to resolve tax controversies and review administrative decisions of the IRS in a fair and impartial manner, for the purposes of enhancing public confidence, promoting voluntary compliance, and ensuring consistent application and interpretation of Federal tax laws. Resolution of tax controversies in this manner is *generally available to all taxpayers*, subject to reasonable exceptions that the Secretary may provide. Thus, cases of a type that are referred to Appeals under present law remain eligible for referral to Independent Appeals.[16] [Emphasis added.]

[10] H.R. Rep. No. 116-39 (House TFA Report), at 29 (2019).

[11] IRS Office of Appeals, "Appeals Team Case Leader Conferencing Initiative: Summary of Finding and Next Steps" (Sept. 2021).

[12] National Taxpayer Advocate, "Require Taxpayers' Consent Before Allowing IRS Counsel or Compliance Personnel to Participate in Appeals Conferences," 2022 Purple Book, at 79-80.

[13] *Id.*

[14] *See* Saul Mezei and John Craig, "The Appeals Access Saga Continues," *Tax Notes Federal*, Aug. 8, 2022, p. 929.

[15] *Id.*

[16] House TFA Report, at 30-31.

The proposed regulations ignore the fact that most of this language ended up in the final language of the TFA and in the code. Instead, Treasury and the proposed regulations characterize the phrase "subject to reasonable exceptions" far more broadly than Congress intended:

> the Treasury Department and the IRS retain after the enactment of the TFA their historical discretion to determine whether the resolution of particular types of disputes is appropriate for the Appeals resolution process, or the discretion of the IRS to determine whether a particular Federal tax controversy is appropriate for the Appeals resolution process.[17]

The rules of statutory construction mandate that no statutory language is superfluous,[18] and yet the proposed regulations set forth the IRS's intent to simply ignore statutory language. The proposed regulations intend to exclude from Appeals all disputes and issues the IRS claims were, or should have been, within its right to exclude from Appeals before enactment of the TFA — rendering the TFA a nullity on the issue of access to Appeals.

Designated Cases or Issues

Designation of cases for litigation is supposed to be rare.[19] It is not. Often the designation is by category and not by the specific facts of the case. The proposed regulations provide a catchall regarding access to Appeals:

> Also, Chief Counsel will withhold from Appeals a Tax Court case or one or more issues in a Tax Court case if Chief Counsel determines referral is not in the interest of sound tax administration. For example, Chief Counsel may decide not to refer a Tax Court case to Appeals when the Tax Court case involves a significant issue common to other cases in litigation for which it is important that the IRS maintains a consistent position.

While cases the IRS has designated for litigation do have access to Appeals, none appear to have settled except for those with full taxpayer concession outside the Appeals process. This author is unaware of *any* case designated for litigation that has settled at Appeals. Whether such a result is because the chief counsel's position requires that it offer no settlement terms, or because Appeals simply accepts the chief counsel's directive that there are no hazards of litigation, the result is the same: Appeals offers no settlement terms to taxpayers. The IRS understands that the TFA requires that all taxpayers generally have access to Appeals, even if in name only. The proposed regulations would completely remove access to Appeals for cases designated for litigation.

In many cases designated for litigation, the IRS is not arguing in Tax Court that there was fraud. Instead, the IRS is merely arguing that the amount (of income, basis, deduction, etc.) claimed by the taxpayer is incorrect. Accordingly, trials and opinions are about value and any related penalties. This evaluation by the Tax Court is exactly the type of evaluation that takes place at Appeals for every other type of case.

The issue, then, is not Appeals' competence; it is about control. While the IRS may be designating issues for litigation to find more clarity in the law, it is preventing sound tax administration by refusing to even try to get to the right amount of tax or a deduction in thousands of cases while simultaneously denying access to Appeals, which could also get to the right amount of tax or a deduction.

That approach would be practical if the IRS actually selected test cases and sent the remaining cases to Appeals for consideration, but that is not what it is doing. Hanging its hat on consistency, the IRS offers settlement only if taxpayers concede all issues, including all penalties. Thus, and by

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[17] REG-125693-19 (Sept. 13, 2022).

[18] *See TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001):
It is "a cardinal principle of statutory construction" that "a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant." *Duncan v. Walker*, 533 U.S. 167, 174 (2001) (internal quotation marks omitted); *see United States v. Menasche*, 348 U.S. 528, 538-539 (1955) ("It is our duty 'to give effect, if possible, to every clause and word of a statute.'" (quoting *Montclair v. Ramsdell*, 107 U. S. 147, 152 (1883))). . . . We are "reluctant to treat statutory terms as surplusage in any setting," *ibid.* (internal alteration and quotation marks omitted), and we decline to do so here.

[19] *See* IRS, "Memo Updates Procedures for Designating Cases for Litigation" (Aug. 24, 2020); *see also* IRS, "IRS Extends Interim Guidance on Designating Cases for Litigation," NHQ-04-0521-0003 (May 24, 2021); and IRM 4.10.28.1.1 (Apr. 4, 2022).

selecting for examination every case it can shoehorn onto the designated-for-litigation list, the IRS has created a backlog in the Examination Division and the Tax Court. Then, by refusing any settlement at any stage and preventing access to Appeals, the IRS ensures that no taxpayer receives any consideration of its particular facts and circumstances until it pays for trial in the Tax Court, and potentially the court of appeals (and then potentially in the Tax Court again) many years after the IRS initiates any examination. The proposed regulations indicate that the IRS wants this expensive and lengthy process to be the rule going forward for any issue chief counsel seeks to add to its ever-increasing list of expansive exceptions to the Appeals process.

Of course, settlements at Appeals are not binding on any other taxpayer or on chief counsel's litigation position. There is no whipsaw at issue if Appeals settles any of the cases or issues outlined in the 24 exceptions. One wonders why chief counsel is concerned by Appeals' settlements at all. Should the IRS decide to offer settlements in the future, it would provide them on a consistent basis based on the applicable facts and circumstances of the case. Doing so has nothing to do with Appeals' function. Until the IRS decides to offer settlement terms other than full concession by the taxpayer, Appeals should continue to be generally available to all taxpayers as outlined in section 7803(e)(4).

Regulation or Guidance Challenges

The proposed regulations exclude from Appeals consideration issues and cases involving challenges to various levels of IRS published guidance. Once again, these exceptions are not narrowly tailored — they literally encompass any challenge to almost any level of published guidance,[20] which only expands the vast list of cases ineligible for Appeals consideration.

The IRS is increasingly hostile to any taxpayer questioning public guidance, making Appeals access more important, not less.[21] Challenges to published guidance, however, do not always spring spontaneously from the taxpayer. In many cases the challenge results from the IRS shifting its position and applying published guidance differently, even when there is no change to the language. The IRS would exclude all such cases and issues from Appeals consideration under the proposed regulations.

Rather than risk liability after a transaction, some taxpayers are seeking reassurance that it falls within the guidance. But even that avenue has now been cut off. The IRS has taken the position that requests for guidance will first be considered with the assumption that any reduction of federal tax in the transaction may, in and of itself, make the request ineligible for guidance; the IRS therefore may not even consider the substantive request.[22]

Since *Mayo*,[23] most cases challenging regulations and other published guidance are based on Administrative Procedure Act arguments. In these cases, the IRS continues to take the position that various guidance is either not subject to the APA or that the IRS complied with the APA in issuing the guidance. These are neither a small number of cases, nor are the issues

[20]The proposed regulations exclusions include challenges to regulations, notices, revenue procedures, technical advice memoranda, private letter rulings, etc.

[21]*See* ILM 202235009 (Sept. 2, 2022) (a corporation was otherwise entitled to make payment by way of eight installments, but when the corporation challenged the application of a regulation, the IRS determined that the corporation was no longer entitled to installment payments and would be treated as if the portion related to the regulation challenge was due to negligence or intentional disregard and the full amount was due after notice and demand). The IRS position is without regard to whether the corporation files Form 8275-R, "Regulation Disclosure Statement," and without regard to whether the return itself is timely. *See also* draft Schedule UTP, "Uncertain Tax Position Statement" (Oct. 7, 2022).

[22]IRS, "Rulings or Determination Letters on Abusive Transactions," Policy Statement 7-76 (Rev. 1) (Aug. 4, 2022).

Original language:

(1) Rulings or determination letters on schemes or devices

(2) A favorable ruling or determination letter is not issued on the tax consequences of schemes, devices, and plans that have as their *principal purpose* the avoidance or reduction of Federal taxes.

New language:

(1) Rulings or determination letters on abusive transactions

(2) A favorable ruling or determination letter is not issued on the tax consequences of abusive transactions that have as a *significant purpose* the avoidance or reduction of Federal taxes.

These language changes are evidence that the IRS is further curtailing PLRs and determination letters. Since there is no definition of significant, it is possible the IRS will take the position that any transaction including the reduction of federal taxes is ineligible for guidance and later for Appeals consideration, including valid transactions that also reduce federal taxes. The IRS guidance provides no thresholds or safe harbors.

[23]*Mayo Foundation for Medical Education and Research v. United States*, 562 U.S. 44 (2011).

frivolous. Even assuming Treasury and the IRS internally reviewed the published guidance does not mean Appeals lacks the ability to review APA challenges to regulations and assign hazards of litigation. Nonetheless, the proposed regulations provide:

> In light of the extensive review and approval procedures at senior levels in both the Treasury Department and the IRS, we believe that it would be inappropriate for Appeals to consider arguments regarding the validity of Treasury regulations in the absence of an unreviewable Federal judicial decision holding the regulation invalid.

Further, the idea that there must be an "unreviewable Federal judicial decision holding the regulation invalid" ignores that the proposed regulations appear to require an opinion, in the taxpayer's own circuit, on the specific portion of the published guidance challenged, and that such opinion be unreviewable. This is nonsense. Treasury and IRS have no basis to hold Appeals to a different, and higher, standard than that of the Department of Justice or the solicitor general appearing on behalf of the IRS before the courts of appeals or the Supreme Court.

Hazards of Litigation

Hazards of litigation are the primary reason taxpayers look to Appeals. Hazards can be factual, evidentiary, or legal,[24] and assigning hazards is a major role of Appeals.[25] Thus, taxpayers often bring both documents and witnesses so Appeals officers may see evidence and listen to the narrative the taxpayer would tell a finder of fact. The purpose of assigning hazards of litigation is to make an educated decision, which Appeals does routinely in all cases before it.

The Internal Revenue Manual instructs Appeals that "the hazards of litigation are the uncertainties of the outcome of the court's decision in the event of a trial."[26] The proposed regulations more narrowly define hazards or remove consideration of hazards from Appeals altogether in cases involving challenges to IRS regulations or published guidance. The proposed regulations specifically provide that:

> unlike most Appeals analysis, which weigh litigation hazards in applying the law to specific facts, considering the validity of a regulation does not involve taxpayer specific facts. A Federal court's unreviewable decision is a determination by the judicial branch on the merits of the validity challenge that may reject the determinations made by other levels of the Treasury Department or the IRS with regard to the validity of a Treasury regulation, *thereby providing a basis for Appeals to consider a regulation's validity*. Accordingly, the Treasury Department and the IRS believe that it would be inappropriate for Appeals to consider challenges to the validity of a Treasury regulation unless a Federal court has rendered an unreviewable decision holding that the regulation is invalid. [Emphasis added.]

Ignoring both the general rule of assigning hazards and the potential that it may be the IRS that is applying the regulation to a taxpayer in a new and different manner, the IRS and Treasury are intentionally hobbling Appeals by removing these challenges from its consideration entirely. Doing so prevents Appeals from even considering the possibility that the IRS might be incorrect.

Law in the Sixth Circuit illustrates this problem with the proposed regulations. In *Mann*

[24] *Id.*

[25] IRM 8.11.1.2.7.5 (July 3, 2019):
(1) Penalties may be settled based on hazards of litigation. Unlike Compliance, Appeals may consider the hazards of litigation in attempting to reach a settlement. The proper use of this settlement authority given to Appeals is critical in fulfilling its mission.
(2) The settlement process is based on the [Appeals Technical Employee]'s experience and judgment after considering the facts and the law.
(3) [Appeals Technical Employees] must evaluate the facts pertinent to the issue under consideration, the applicable law, and the potential outcome in the event the case is litigated.
(4) The hazards of litigation are the uncertainties of the outcome of the court's decision in the event of a trial.
(5) Litigating hazards generally fall into three categories: factual, legal and evidentiary. Note: Lack of case law should not be considered a hazard of litigation.
(6) Appeals may weigh these factors and determine an appropriate settlement range for the issue and obtain a realistic settlement.

[26] *Id.*

Construction[27] the circuit deemed Notice 2007-83, 2007-45 IRB 960, invalid because it was required to be promulgated after notice and comment procedures under the APA. Since that time, the government has conceded that the reasoning in *Mann* applies with equal force to Notice 2017-10, 2017-4 IRB 544.[28] But under the proposed regulations, even a taxpayer residing in the Sixth Circuit would be barred from Appeals' consideration of challenges to Notice 2017-10 because *Mann* specifically addresses only Notice 2007-83.

Conclusion

The government has nearly unlimited resources to litigate its cases in the Tax Court, courts of appeals, and Supreme Court. However, under the IRM 35.5.1.3 (Aug. 11, 2004):

> the established goals of both the Office of Chief Counsel and the Service are to settle as many Tax Court cases as possible at the earliest possible date prior to the cases being calendared for trial, to prepare adequately for trial those cases not settled, and to dispose of all pending cases in the most efficient and expeditious manner.

Further, under Tax Court Rule 1(d), the court's rules "shall be construed to secure the just, speedy, and inexpensive determination of every case." Instead, the IRS is hampering the efficient operation of the Tax Court by refusing to allow Appeals to compromise in the thousands of cases designated for litigation.

These proposed regulations only bind Appeals' hands further. Appeals is supposed to be a safety valve for effective tax administration in which personality conflicts and disagreements over the law are resolved informally and with respect. The safety valve should be accessible to the taxpayer in all but extremely limited cases. The list of 24 exceptions is exceedingly broad in scope and swallows the rule from section 7803(e)(4) that generally all taxpayers are entitled to access Appeals, with all that entails (including a fair and impartial review of the facts and circumstances of each case).

The proposed regulations, along with the other IRS actions outlined above, would turn Appeals into merely another controlled arm of the IRS whose role is to support the IRS's litigation positions. That is not what the TFA intended, and it is not what the law requires. ■

[27] *Mann Construction Inc. v. United States*, 27 F.4th 1138 (6th Cir. 2022).

[28] *See* Answer, *GBX Associates LLC v. United States*, No. 1:22-cv-00401-PAB (N.D. Ohio May 20, 2022). In his answer, the commissioner also admitted "that Notice 2017-10 is a rule subject to notice-and-comment procedures based on controlling Sixth Circuit precedent in *Mann Construction*." However, the government maintained that it "is not bound by this admission outside the Sixth Circuit and may argue in other jurisdictions that Notice 2017-10 is excepted from the APA's notice-and-comment procedures." The government made no such reservation in admitting that Notice 2017-10 didn't follow the APA's notice and comment process. Again, this article was submitted before the decision in *Green Valley Investors*, 159 T.C. No. 5, which struck down Notice 2017-10.