Final Appeals Regs Stand Firm On Rule Challenge Exceptions

by Nathan J. Richman

The IRS and Treasury clarified a few rules in final regulations governing access to the Independent Office of Appeals but mostly kept the rule barring challenges to statutes or regulatory guidance.

Issued January 14, the final regs (T.D. 10030) governing changes to the internal appellate practice at the IRS under the Taxpayer First Act mostly stayed the course on the proposals that attracted the loudest complaints from taxpayers and tax professionals.

The proposed regs (REG-125693-19), released in 2022, listed 24 exceptions to the general availability of Appeals to taxpayers who didn't agree with IRS auditors' conclusions. Most weren't particularly controversial, but many responses to the proposal challenged the exceptions that would prevent Appeals from considering arguments that a statute is unconstitutional or a reg, notice, or revenue procedure is procedurally invalid.

The IRS and Treasury received 14 comments on the proposed regs and held a hearing in November 2022.

The final regs come amid a deluge of guidance as the Biden administration prepares to give way to a second Trump administration. The TFA passed in 2019, during President-elect Trump's first administration, and renamed and clarified Appeals.

"Treasury and the IRS should be commended for their attempt to address a plethora of comments they received in connection with the proposed regulations. It is not lost on taxpayers the effort that went into analyzing and responding to those comments," Brian W. Kittle of Mayer Brown told *Tax Notes*.

Elizabeth K. Blickley of Fox Rothschild LLP said she found the preamble interesting for incorporating some case law that had developed since the proposed regs were released in 2022. However, it's also notable that the IRS and Treasury didn't mention *Loper Bright Enterprises Inc. v. Raimondo*, 144 S. Ct. 2244 (2024), or *Corner Post Inc. v. Federal Reserve*, 144 S. Ct. 2440 (2024), two cases in mid-2024 in which the Supreme Court changed the administrative law landscape, she said.

In addition to the hot-button question of Appeals hearing challenges to statutes, regulations, notices, and revenue procedures, the final regs contained clarifications regarding application to exempt organizations, including an example concerning appeal in docketed cases, and confirmed the rule that taxpayers can go to Appeals only once.

Searching for Precedent

The IRS and Treasury rejected most of the calls for changes to the challenged exceptions in the final regs.

Exception 18 restricts Appeals from hearing arguments that statutes are unconstitutional. Exceptions 19 and 20 prevent Appeals from hearing promulgation procedure challenges to regs and some subregulatory guidance, respectively.

In response to complaints that those exceptions deny taxpayers statutory appeal rights, the preamble said that section 7803(e)(4) only offers "generally available" access to Appeals, rather than an absolute right. The IRS and Treasury also pointed to legislative history discussing the secretary's ability to carve out exceptions to Appeals access.

The basic idea, according to the government, is that Appeals shouldn't be the first place a rule is determined to be invalid. Those challenges should first be addressed by courts because the results will be public and cover all taxpayers, according to the IRS and Treasury.

If taxpayers can present challenges to statutes or guidance to Appeals, any determination would be private and taxpayer-specific, according to the preamble. In other words, the IRS and Treasury want courts to make precedent on taxpayer assertions that a rule is invalid before Appeals settles similar cases.

"Appeals does not have the authority to unilaterally contradict the decisions made through the regulatory or subregulatory process," the preamble said.

The proposed regs would have allowed taxpayers to take rule challenges to Appeals once a federal court has accepted the argument in a ruling not subject to further review.

The final regs clarify that provision by removing language about later proceedings in the court cases and by explicitly stating that the unreviewable decision doesn't have to come from the circuit covering the taxpayer wishing to take the rule challenge to Appeals. The IRS and Treasury also affirmed that a taxpayer remains free to bring arguments to Appeals about whether a rule applies in a particular situation, including the effect of a change in the law.

The IRS and Treasury accepted a suggestion to spell out what "procedurally invalid" means for exception 20.

Reactions

Alina Solodchikova of RSM US LLP said the decision to retain exceptions 18, 19, and 20 seems unfavorable to taxpayers. Many taxpayers aren't asking Appeals to make the law but instead just want to settle their cases based on hazards of litigation that might involve the possibility of a rule being invalid, she said.

Those exceptions force more issues into litigation, and many taxpayers can't afford to pursue the precedents the IRS and Treasury seem to want, Solodchikova said. That can be especially unfavorable to smaller taxpayers, she said.

Solodchikova said the clarification that an unreviewable decision doesn't depend on the taxpayer's circuit resolved an uncertainty that had been presented to the government.

Blickley welcomed the clarification of "unreviewable decisions" in the final regs but said that retaining the limitation on legal challenges to rules seems to narrow the mission of Appeals.

Challenges to regs and other rules aren't afterthoughts but can be basic case advocacy, Blickley said. In many cases, challenging statutes, regs, and other guidance is a general best practice that might be part of a tax representative's ethical obligation, she said.

Further, the ability to raise an argument to Appeals can affect a taxpayer's rights in Tax Court, Blickley said.

When taxpayers don't receive properly mailed notices of deficiency, they can still challenge their underlying tax liabilities in collection due process cases, but only to the extent they present those arguments to the Appeals personnel conducting their CDP hearings. Blickley was concerned about taxpayers being restricted by the final Appeals regs in those situations.

Kittle said the final regs provide a clearer description than the proposed regs of the "unreviewable decisions" that define the limits of exceptions 18, 19, and 20. However, questions remain regarding how much weight will be given to precedents from different courts, he said.

While the IRS and Treasury place great emphasis on the idea of consistency to be gained from focusing on judicial rulings for challenges to rule validity, that reasoning seems inconsistent with how Appeals generally resolves cases, according to Kittle.

"IRS Appeals consistently tells taxpayers that it imposes consistent taxpayer treatment on similar tax disputes despite taxpayers not having access to other taxpayer settlements due to section 6103," Kittle said. "In short, taxpayers do not have access to Appeals settlements with other taxpayers, yet IRS Appeals generally makes it clear that they are attempting to coordinate those results." ■