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Rev. Proc. 2016-22 Clarifies the Practices for the Administrative Appeals Process in Cases Docketed in the Tax Court

On March 23, 2016, the IRS issued Rev. Proc. 2016-22[1] superseding Rev. Proc. 87-24 and detailing procedures for the consideration by IRS Office of Appeals ("IRS Appeals") of cases docketed in the United States Tax Court ("Tax Court"). IRS Appeals is a separate office within the IRS, which is tasked with providing an independent forum to help the Government and taxpayer resolve issues. In 2015, the IRS issued Notice 2015-72 seeking comments on the proposed new procedures.[2] Rev. Proc. 2016-22 notes that a number of suggestions, submitted in response to Notice 2015-72, were not adopted in this Revenue Procedure, but may be addressed by the IRS in the future through information guidance such as the Internal Revenue Manual or Chief Counsel Directives Manual.

Below is a summary of several of the key provisions of Rev. Proc. 2016-22, which is applicable to all docketed Tax Court cases pending on or after March 23, 2016.

Under Rev. Proc. 2016-22, the IRS Office of Chief Counsel ("Counsel"), who represents the Commissioner of the Internal Revenue Service in Tax Court, is directed to refer all docketed Tax Court cases to IRS Appeals unless either: (1) IRS Appeals issued the notice of deficiency or made the determination that is being litigated in the Tax Court, or (2) the taxpayer notifies Counsel that it wishes to forego having its case considered by IRS Appeals. If IRS Appeals issued the notice of deficiency or determination without having fully considered all issues

[1] 2016 I.R.B. LEXIS 236.
[2] 2015-44 I.R.B. 613.

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because of an impending expiration of a statute of limitations, then IRS Appeals may request that IRS Counsel return the case to it once it has become docketed in the Tax Court. Additionally, Counsel will not refer any docketed case or issue that has been designated for litigation, or in limited circumstances, if it is determined that the referral is not in the interests of sound tax administration. As an example of a situation where referral to IRS Appeals is not in the interest of sound tax administration, Rev. Proc. 2016-22 provides that Counsel may decide not to refer a docketed case to IRS Appeals where there is a significant issue common to other cases where the IRS must maintain a consistent position. If a docketed case or issue is not to be referred to IRS Appeals, Rev. Proc. 2016-22 provides that counsel will notify the taxpayer.

Notwithstanding the above exclusions, Rev. Proc. 2016-22 provides that Counsel should refer docketed cases to IRS Appeals within 30 calendar days of the case becoming "at issue in the Tax Court," as defined by the Tax Court rules of procedure. Counsel does, however, have the discretion, with managerial approval, to delay forwarding a case; if Counsel does so, it must follow certain procedural steps if the delay is more than 90 calendar days. The taxpayer will be notified of the delay in this instance and Counsel will discuss the potential timing with IRS Appeals. Rev. Proc. 2016-22 notes that a few potential examples of a delay in transferring the docketed case to IRS Appeals are instances when new facts are raised in Tax Court pleadings, or when Counsel anticipates filing a dispositive motion with the Tax Court.

Importantly, Rev. Proc. 2016-22 provides that once a docketed case is referred to IRS Appeals, the Appeals officer has sole authority to settle the case until the docketed case is transferred back to Counsel. Rev. Proc. 2016-22 provides that IRS Appeals may request advice from Counsel in evaluating the merits of the case and settlement. Although Rev. Proc. 2016-22 allows Counsel to request to be included in a settlement conference with the taxpayer, IRS Appeals may, with manager approval, decline to include Counsel in the settlement conference if it determines that Counsel's participation will not aid in the settlement process. These provisions supersede the provisions in Rev. Proc. 87-24, which allowed for joint consultation between IRS Appeals and Counsel in certain instances, such as cases involving significant issues or large deficiencies, although IRS Appeals retained settlement authority. Under Rev. Proc. 87-24, in these instances, Counsel acted in an advisory capacity and also attended settlement conferences with the taxpayer.

Rev. Proc. 2016-22 also provides that IRS Appeals and Counsel may transfer the case between the two divisions, and that the administrative file, or a copy of the file, should be available for Counsel for trial preparation. IRS Appeals is directed to provide Counsel with access to any documents received during a settlement conference. If a taxpayer raises a new issue during the IRS Appeals process, then IRS Appeals is directed to notify Counsel and, if necessary, both Counsel and IRS Appeals will coordinate in sending the case back to the examination function for further development prior to IRS Appeals' consideration of the case.

In certain instances, Counsel may alert IRS Appeals of the potential timeline for litigation, and Counsel and IRS Appeals may agree on a settlement timeline to return the case to IRS Appeals. Additionally, Counsel has the ability to recall certain "small" tax cases[3] within six months, or the case will be returned at least 30 days before the scheduled Tax Court calendar

[3] These are cases that are governed by Internal Revenue Code Section ("Section") 7463 or a case in which the amount at issue for each year is $50,000 or less.

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call. In other cases, IRS Appeals will return the case to Counsel either when (1) it is determined by IRS Appeals that the case cannot be settled or (2) 10 calendar days after the case appears on a Tax Court trial calendar. In both instances, if it appears that settlement is reasonably likely, Counsel and IRS Appeals may agree to extend the time for consideration of the case by IRS Appeals.

Rev. Proc. 2016-22 specifically notes that the rules prohibiting *ex parte* communications under Rev. Proc. 2012-18[4] apply to communications between IRS Appeals and the originating function (*e.g.*, Examination team), but do not apply to communications between Counsel and IRS Appeals with respect to a docketed Tax Court case. The *ex parte* rules, contained in Rev. Proc. 2012-18, generally provide for certain prohibitions on communications between IRS Appeals and the originating IRS division without the presence of the taxpayer to ensure the independence of IRS Appeals.

Lastly, Rev. Proc. 2016-22 notes specific instances where the procedures described herein will not be applicable. These instances include cases docketed under Sections 6015(e)(1)(A)(i)(II), 6110, 6320, 6330, 6404, 7428, 7476, 7477, 7478, 7479 and 7623.

Tax Court Determines that Mitigation Applies to Correct an Exclusion of Income at the Beneficiary Level of a Trust

In *Costello v. Comm'r*,[5] petitioners Sally Costello and Brian Costello (collectively, "Beneficiaries") challenged proposed deficiencies asserted by the IRS on the grounds that the assessment statute of limitations had expired for their 2001 tax years. The IRS asserted that the mitigation provisions found in Sections 1311-1314 of the Internal Revenue Code applied to allow the assessment of the proposed deficiencies.

As way of background, the Beneficiaries were the beneficiaries of the James V. Costello 1993 Trust ("Trust") created by their father. In 2001, the Trust received distributions totaling $228,530 from an Individual Retirement Account established by the Beneficiaries father ("JH distributions"). The Trust then made a distribution of $114,265 to each of the Beneficiaries in 2001 related to the JH distributions.

The Trust timely filed Form 1041, *US Income Tax Return for Estates and Trusts*, for its 2001 tax year. On this return, the Trust reported the JH distributions as income of $228,530 and also reported a related income distribution deduction of $228,699 that essentially caused it to have negative taxable income and no tax due. The Trust issued Schedules K-1, *Beneficiary's Share of Income Deductions, Credits, etc.*, showing that each of the Beneficiaries received income of $114,265 in 2001. The Beneficiaries each timely filed a 2001 Form 1040, *US Individual Income Tax Return*. On their respective returns, the Beneficiaries reported the income of $114,265 from the Trust.

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[4] 2012-1 C.B. 455.
[5] T.C. Memo 2016-33.

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In 2004, the IRS examined the Trust's 2001 return and determined that the JH distributions were properly taxable at the Trust rather than the Beneficiaries. The Trust and the Beneficiaries signed agreements with the IRS accepting this position, which led to a deficiency for the Trust and refunds to the Beneficiaries for 2001. The IRS issued refunds to the Beneficiaries and the Trust, through its Beneficiaries, paid the deficiency during 2005 and 2006.

After the conclusion of the IRS examination of the Trust's 2001 Form 1041, the Trust filed an amended 2001 Form 1041claiming the deduction for the JH distributions and sought a refund for the amounts paid pursuant to the examination agreement. On August 8, 2008, the IRS accepted the Trust's refund claim.

The IRS subsequently issued notices of deficiencies to the Beneficiaries assessing additional tax for the inclusion of JH distributions for their respective 2001 tax years. Although the Beneficiaries acknowledged that it was a windfall, *i.e.*, the Beneficiaries did not pay tax on the JH distributions, nor did the Trust due to the refund, they argued that the assessments were invalid due to the closure of the statute of limitations for tax year 2001.

The IRS did not dispute that the statutes of limitations were otherwise closed, but asserted that it properly met the requirements to utilize mitigation to reopen the Beneficiaries' 2001 tax returns for a correlative adjustment related to the Trust's refund claim. In response, the Beneficiaries asserted that mitigation was inapplicable for the following reasons (1) the IRS caused the error through its examination, (2) there was no inconsistent position and (3) the requisite relationship between the Trust and the Beneficiaries did not exist to justify mitigation.

Background

Generally, under Section 6501, the statute of limitations for assessment is three years from the date of filing a return, subject to certain exceptions set forth in the statute. Some examples of these exceptions are extension by agreement, false or fraudulent return, and failure to notify of certain transactions. The Tax Court noted that in this situation there were no applicable exceptions to extend the statute of limitations under Section 6501 to 2009, the year in which the notices of deficiency were issued by the IRS.

Mitigation is an equitable doctrine, which has been codified in Sections 1311-1314, and is designed to allow a party to reopen a closed tax year under specific parameters to correct an error and typically prevent a windfall to one party. The mitigation provisions are only applicable for certain types of situations called circumstances of adjustment, which are set forth in Section 1312 and include items such as a double inclusion or double exclusion of an item of gross income.

Generally, the party seeking to assert mitigation must show the following: (1) an error in a closed tax year, (2) there was a determination about the treatment of an income, deduction, credit or basis in property, (3) the determination results in a circumstance of adjustment as set forth in Section 1312, and (4) for the majority of the circumstances of adjustment there must be

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an inconsistent position maintained by the party against whom mitigation is asserted.[6] Lastly, the mitigation provisions also require that the correction of the error is now barred by the statute of limitations, but was not barred at the time of the erroneous action.

Analysis

As noted above, the IRS asserted that this situation properly fell under mitigation to allow it to reopen the Beneficiaries' 2001 tax year and assess deficiencies related to the exclusion of distributions the Beneficiaries received from the Trust. The Beneficiaries asserted that mitigation did not apply as the IRS created the issue, they did not maintain an inconsistent position and the proper relationship did not exist to utilize mitigation between the Trust and Beneficiaries.

The Tax Court dismissed the Beneficiaries' argument that mitigation was not applicable as the IRS examination caused the change in tax position. The Tax Court noted the mitigation provisions applied equally regardless of how the situation was created, thus the IRS could utilize mitigation to correct the error if the requirements for mitigation were met.

Next, the Tax Court examined the following mitigation requirements: (1) a determination, (2) a circumstance of adjustment, and (3) whether the correction was barred at the time of the determination, to evaluate whether the IRS could utilize mitigation. Under Section 1313, a determination includes a decision by the Tax Court, closing agreement under Section 7121 and a final disposition by the Secretary of a claim for refund. In this instance, the Tax Court held that the IRS acceptance of the Trust's refund for the tax year 2001 constituted a determination for mitigation purposes.

Section 1312 contains seven circumstances of adjustment to which the mitigation provisions can apply. The Tax Court noted that the relevant circumstance of adjustment in this case was Section 1312(5), which provides:

> The determination allows or disallows any of the additional deductions allowable in computing the taxable income of estates or trusts, or requires or denies any of the inclusions in the computation of taxable income of beneficiaries, heirs, or legatees, specified in subparts A to E, inclusive (secs. 641 and following, relating to estates, trusts, and beneficiaries) of part I of subchapter J of this chapter, or corresponding provisions of prior internal revenue laws, and the correlative inclusion or deduction, as the case may be, has been erroneously excluded, omitted, or included, or disallowed, omitted, or allowed, as the case may be, in respect of the related taxpayer.

The Tax Court held that this situation fell under the above, as the Trust was granted a refund for the tax year 2001based on the deduction for the JH distributions it had received, but there was no correlative inclusion of income at the Beneficiaries.

Lastly, the Tax Court noted that the Beneficiaries' 2001 returns were closed for purposes of assessment on August 8, 2008, the date that the Trust's refund claim was granted, *i.e.*, the

[6] A party is not required to show an inconsistent position if there is a double exclusion of item of gross income or double disallowance of deduction or credit. *See* Section 1311(b)(1).

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determination. Accordingly, the Tax Court concluded that the IRS met the standards for mitigation.

The Beneficiaries asserted that the Trust filed the amended return to correct the IRS error pursuant to the examination and that this return was consistent with the Trust's original return, thus there was no active inconsistency. The IRS argued that the Trust's claim for refund constituted an inconsistent position from the amended returns, pursuant to the examination, as it excluded the JH distributions as taxable income, which were distributed to the Beneficiaries. The Tax Court held that the Beneficiaries had accepted the position that the income was properly taxable at the Trust level, pursuant to the examination, and the Trust took an inconsistent position upon filing its income tax return.

The Beneficiaries also asserted that the requisite relationship did not exist at the time of the inconsistency, *i.e.*, the 2006 refund claim, as the Trust terminated in 2003. Under Section 1311(b)(3), an adjustment for a related taxpayer is not allowed unless that taxpayer stands in the relationship to the taxpayer at the time of the inconsistent position, or if such position is not maintained, at the time of the determination. The Tax Court noted that for mitigation to apply, the Beneficiaries needed to be in a relationship when the Trust first maintained its inconsistent position, *i.e.*, 2006, and also during 2001, the tax year at issue. The Tax Court held that the Beneficiaries had not proved that the Trust terminated, and regardless, the Beneficiaries were still acting in the fiduciary-beneficiary capacity when the Trust filed the refund claim, and subsequently received refunds that profited the Beneficiaries. Accordingly, the requisite fiduciary-beneficiary relationship existed for mitigation.

Based on the above analysis, the court held that the IRS had satisfied the mitigation requirements and thus could assess deficiencies on the Beneficiaries' 2001 returns. Accordingly, the notices of deficiency sent on September 2, 2008 to the Beneficiaries were timely.

Rev. Proc. 2016-19 Updates the IRS's Industry Issue Resolution Program Procedures

Industry Issue Resolution Program Background

The IRS initially introduced the Industry Issue Resolution Program (the IIR Program) as a pilot in Notice 2000-65,[7] establishing a procedure to address frequently disputed tax issues common to a significant number of large or mid-size business taxpayers through pre-filing guidance, rather than post-filing examination. The IIR Program was open to these taxpayers, as well as industry associations and other groups, to suggest issues and possible options for resolution. Through the IIR Program, the IRS would select issues to address and then publish guidance on those issues, likely in the form of a Revenue Procedure, that would permit taxpayers to adopt a recommended treatment of an issue on future tax returns.

[7] 2000-2 C.B. 599.

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In Notice 2002-20,[8] the IRS announced that the IIR Program would be made permanent, and expanded it to include issues common to taxpayers under the jurisdiction of the Small Business and Self-Employed (SB/SE) division. Subsequently, the IRS issued Rev. Proc. 2003-36[9] to revise certain procedures for submitting issues for consideration. Rev. Proc. 2003-36 continued to limit submissions under the IIR Program to taxpayers under the jurisdiction of the Large and Mid-Size Business (now Large Business and International or LB&I) division and the SB/SE division.

Rev. Proc. 2016-19,[10] issued on March 4, 2016, supersedes Rev. Proc. 2003-36, and expands the availability of the IIR Program to include issues common to taxpayers under the jurisdiction of the Tax Exempt and Government Entities (TE/GE) division. Rev. Proc. 2016-19 also updates and clarifies the procedures for participation in the IIR Program. Rev. Proc. 2016-19 is effective as of April 25, 2016.[11]

IIR Program Scope[12]

In general, the types of issues that are most appropriate for consideration under the IIR Program have two or more of the following characteristics: (1) the proper tax treatment of a common factual situation is uncertain; (2) the uncertainty results in frequent, and often repetitive, examinations of the same issue; (3) frequent, and often repetitive, examinations require significant resources from both the IRS and impacted entities; (4) the issue is significant and impacts a large number of entities; (5) the issue requires extensive factual development; and (6) collaboration would facilitate proper resolution of the tax issues by promoting an understanding of entities' views and business practices. By contrast, the following issues are generally not well-suited for consideration under the IIR Program: (1) issues unique to one or a small number of entities; (2) issues not under the jurisdiction of either LB&I, SB/SE, or TE/GE; (3) issues involving transactions that lack a *bona fide* business purpose, or transactions with a significant purpose of improperly reducing or avoiding federal taxes; and (4) issues involving transfer pricing or international tax treaties.

Specific Changes in Rev. Proc. 2016-19

While Rev. Proc. 2016-19 is similar in many respects to Rev. Proc. 2003-36, there are a few notable changes. As mentioned above, a significant update to the IIR Program is that certain issues common to taxpayers under the jurisdiction of TE/GE are now eligible for consideration.[13] In addition, Rev. Proc. 2016-19 adds a section with respect to who can submit a request for consideration of an issue, providing: "In general, a requester should be an organization or a group of entities that represents a significant number and cross section of the entities with the particular tax issue or issues."[14]

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[8] 2002-1 C.B. 796.
[9] 2003-1 C.B. 859.
[10] 2016-13 I.R.B. 497.
[11] 2016-13, Section 9.
[12] Rev. Proc. 2016-19, Sections 3.01 and 3.03.
[13] *See* Rev. Proc. 2016-19, Section 2.03.
[14] Rev. Proc. 2016-19, Section 3.04.

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The IRS previously identified the burden to taxpayers caused by the uncertainty of the proper tax treatment as a characteristic of the type of issue appropriate for consideration under the IIR Program. Pursuant to Rev. Proc. 2016-19, the burden to not only taxpayers, but also the IRS and other impacted entities is now a relevant characteristic for the purposes of determining whether an issue is appropriate for consideration.[15]

Finally, Rev. Proc. 2016-19 emphasizes collaboration between the IRS and taxpayers, adding the following language: "Consideration of an IIR Program request is intended to be a collaborative effort that fosters constructive dialogue in an attempt to address issues in a manner that enhances good tax administration. This collaboration requires open and transparent discussion of the concerns and goals of all IIR team members."[16] Relatedly, Rev. Proc. 2016-19 provides that the IIR team established by the IRS will now include appropriate personnel from the requester, in addition to the IRS.[17]

IRS Issues Notice Updating List of Designated Private Delivery Services under Section 7502

Under section 7502, when certain documents or payments sent to the IRS are mailed via US mail prior to the deadline but are received after the deadline, the postmark date is deemed to be the date of delivery or payment. Section 7502(f) authorizes the Secretary to designate certain private delivery services (PDSs) for the timely mailing treated as timely filing/paying rule of section 7502.

On April 11, 2016, the IRS issued Notice 2016-30 (the "Notice"), which added eight additional services to the list of designated PDSs, and provided rules for determining the postmark date for returns and other documents delivered using these services.

In accordance with section 7502(f)(2)(C), a PDS is required to either record electronically to its database, keep in the ordinary course of business, or mark on the cover in any item to be delivered, the date on which such item was given to the PDS for delivery. Pursuant to section 7502(f)(1), the date recorded in the database or marked by the PDS under section 7502(f)(2)(C) is treated as the postmark date for purposes of section 7502.

The Notice provides that the postmark date of an item delivered after the due date is presumed to be the day that precedes the delivery date by the amount of time that it would typically take for an item to be delivered under the terms of the specific type of delivery service used. For example, a package arriving via a two-day delivery service is deemed to have been mailed two days before it was delivered. This presumption can be rebutted by the taxpayer with evidence of the actual mailing date from the private delivery service.

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[15] *See* Rev. Proc. 2016-19, Section 3.01; *see also* Rev. Proc. 2003-36, Section 3.01.
[16] Rev. Proc. 2016-19, Section 6.02.
[17] Rev. Proc. 2016-19, Section 6.01.

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On April 11, 2016, the IRS issued Notice 2016-30, which added eight additional services to the list of designated services. A complete, updated list of PDSs is as follows:

DHL: DHL Express 9:00, DHL Express 10:30, DHL Express 12:00, DHL Express Worldwide, DHL Express Envelope, DHL Import Express 10:30, DHL Import Express 12:00, and DHL Import Express Worldwide

FedEx: FedEx First Overnight, FedEx Priority Overnight, FedEx Standard Overnight, FedEx 2 Day, FedEx International Next Flight Out, FedEx International Priority, FedEx International First, and FedEx International Economy

UPS: UPS Next Day Air Early AM, UPS Next Day Air, UPS Next Day Air Saver, UPS 2nd Day Air, UPS 2nd Day Air A.M., UPS Worldwide Express Plus, and UPS Worldwide Express

Any other delivery services provided by DHL, FedEx, and UPS that are not set forth below do not qualify as designated PDSs. The Notice is effective as of April 11, 2016.

Another recent update from the IRS with respect to private delivery services was an update to the IRS's Submission Processing Center street addresses. Those can be found online.
URL: https://www.irs.gov/uac/Submission-Processing-Center-Street-Addresses-for-Private-Delivery-Service-(PDS)

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