

1-1980

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L. Howard Godfrey

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### Recommended Citation

Godfrey, L. Howard (1980) "New IRS Appeals Procedure," *Woman C.P.A.*: Vol. 42 : Iss. 1 , Article 6.  
Available at: <https://egrove.olemiss.edu/wcpa/vol42/iss1/6>

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# New IRS Appeals Procedure

L. Howard Godfrey, CPA, PhD.

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At the conclusion of an audit, the Revenue Agent may propose adjustments which will result in additional tax liability. There are specific procedures by which a taxpayer can object to the assessment of additional taxes. Recently, the IRS made significant changes in these administrative appeals procedures. This article presents some facts about the appeals process, describes the changes made by the IRS, and identifies some of the controversy surrounding the changes.

## Past Appeals Procedure

Until October 2, 1978, a taxpayer wishing to contest a proposed deficiency had two levels of appeals available. After receiving the report of the auditor, the taxpayer or his advisor could request a District Conference. The responsibility for this conference was in the office of the District Director, if the taxpayer was not satisfied with the results of the District Conference, or if the District Conference was bypassed, the taxpayer could obtain a conference with the Appellate Division in the Regional Commissioner's Office. A taxpayer not receiving satisfactory results with the Appellate Conference could file petition with the

Tax Court. Of course, a taxpayer could go to Tax Court without using the administrative appeals process.<sup>1</sup> In either case, the Appellate Division generally would provide a conference after the case was docketed by the tax court. Settlement of a docketed case would require concurrence of regional counsel.

The Internal Revenue Service provided these appeals opportunities in fifty-eight district offices and forty regional branch offices in the United States. In addition, conferences were arranged at other mutually convenient locations.<sup>2</sup> In the last ten years, 97 percent of all disputed cases were closed without trial. In 1978, the appeals function disposed of 54,715 cases by agreement, the Tax Court tried 1,742 cases and 447 cases were tried in District Courts and the Court of Claims<sup>3</sup>. District Conferences resulted in agreement in 68.9 percent of the cases in 1978. Roughly one-half of the cases handled by the Appellate Division were nondocketed cases, i.e., cases in which the taxpayer has not filed a petition with the Tax Court. The remainder were docketed cases. Closing agreements were reached in 70 percent of the nondocketed case and 73 percent of the docketed cases in 1978.

## Internal Revenue Service Proposed Changes

On April 3, 1978, the IRS proposal for elimination of the District Conference was published in the Federal Register.<sup>4</sup> A single appeals function under the Regional Director of Appeals was proposed. The announcement emphasized that the elimination of the District Conference would not eliminate any of the rights of appeal previously enjoyed by taxpayers. The Appellate Division procedures would be changed to preserve these privileges. For example, Appellate Conferences would be available at all locations where District Conferences have been offered.

## The Proposed Change Was Controversial

The May, 1978 issue of *Taxes—The Tax Magazine* contains an article by a former IRS Manager Conferee who supported the change.<sup>5</sup> The August, 1978, issue of the same journal contains an article by a former IRS Assistant Chief Counsel. In this article the author emphasized that the change could cause serious problems.<sup>6</sup> Some of the points raised by these authors will be considered.

In the first article, the author referred to the increasing concern over the effectiveness of the two-step administrative appeal system. His reasons for recommending a single level of appeals were:

1. To strengthen the quality of appeal services, and
2. To increase public confidence in taxpayer opportunities for speedy, low cost resolution of unagreed cases.

The Audit Division has followed a policy of rotating its personnel from one area to another, with the District Conference being one of the specialty areas. This meant that there was less opportunity for the development of competent conferees at the district level than at the appellate level. The elimination of the District Conference should eliminate this problem of the "revolving door" for conferees. Also, a district conferee's authority to settle cases was less than the authority given an appellate conferee. This proposed change would give the taxpayers the benefit of full settlement authority immediately, rather than requiring them to wait until the second conference. Another problem with the

District Conference was the doubt as to its independence from the audit function which proposes the assessments. Removal of the appellate function from the District Director's Office should increase taxpayer confidence in the independence of the appeals function.

In the second article, the author emphasized the importance of the administrative appeals function and suggested caution in modifying it. He noted that in a recent year, the audit of 2.3 million returns resulted in recommended additional taxes and penalties for 1.5 million of those returns. There were 62,000 cases of disagreement over proposed adjustments for that year. However, the Tax Court along with the District Courts and the Court of Claims disposed of less than 2,000 cases by trial and decision.<sup>7</sup> This meant that the appeals machinery accommodated the vast majority of the disputes. If a significantly larger number of taxpayers are unable to get a settlement through the IRS appeals procedure, the court system will find itself flooded with cases. The author considered the Appellate Division to be undesirable for many taxpayers because of:

1. the more formal, technical bargaining approach expected at the Appellate Conference, and
2. the expectation that more highly trained appellate conferees make necessary the retaining of costly outside counsel.

The author expressed concern that these and other features of the new system may cause many taxpayers to bypass the administrative appeal route and go directly into court, thus straining the capacity of the court system.

### The AICPA Opposed The Change

The Federal Tax Division of the AICPA surveyed 400 tax experts within the Institute and found that 82 percent favored retaining the two-level appeal system.<sup>8</sup> The AICPA Tax Division suggested the savings for the government will be illusory because appellate conferences will be available at all district conference locations, thus requiring additional Appellate Division personnel. The AICPA Tax Division predicted the new system will reduce

opportunities for settlement without litigation. Also, taxpayers will be pressured to engage additional professional counsel because a second conference is available only after a petition is filed with the Tax Court.

### IRS Implemented The Change

On October 2, 1978, the proposed changes were implemented by the Internal Revenue Service.<sup>9</sup> All cases scheduled for district conference on that date were transferred to the Appellate Division. In the original proposal, the IRS summarized its views as to the advantages of the new approach. First, the taxpayer should save time and money through the elimination of one level of appeals. Moreover, the taxpayer will not have to wait for a second conference to get the benefit of the greater settlement authority of the Appellate Division. Finally, the government is expected to benefit from the reduced personnel requirements.

### Conclusion

Changes in the appeals procedure will have an impact on those who practice before the IRS. The degree to which the changes will be successful is not clear. One thing is clear: tax practitioners should become thoroughly familiar with the new procedures. □

### Notes

<sup>1</sup>Another alternative would be to pay the disputed tax and file for a refund. Then when the IRS refuses the refund, take the case to District Court.

<sup>2</sup>1977 Annual Report of the Commissioner of Internal Revenue, p. 26.

<sup>3</sup>These statistics are taken from the 1978 Annual Report of the Commissioner of Internal Revenue, pp. 29-30, 97. Statistics for 1978 are for the fiscal year ending September 30, 1978.

<sup>4</sup>Federal Register, Vol., 43, No. 64, Monday, April 3, 1978, p. 13896.

<sup>5</sup>Frank Wolpe, "Thoughts for a Single Level of Appeal," *Taxes—The Tax Magazine*, (May, 1978), pp. 267-271.

<sup>6</sup>Paul E. Trusch, "The District Conference—Can it be Saved and is it Worth Saving?" *Taxes—The Tax Magazine*, (August, 1978), pp. 498-503.

<sup>7</sup>Most cases docketed by the Tax Court are settled in conference between the taxpayer's representative, the appellate conferee, and regional counsel.

<sup>8</sup>"News Report," *The Journal of Accountancy*, (July, 1978), p. 16.

<sup>9</sup>IRS Statement of Procedural Rules—Appellate Functions. Reg. 601.106.

L. Howard Godfrey, CPA, Ph.D., is

Associate Professor of Accounting at the University of North Carolina at Charlotte. His professional memberships include American Taxation Association, North Carolina Association of CPAs, AICPA, AAA, and NAA. He has previously published in the professional literature.

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