



WHEN IS TAX LITIGATION THE RIGHT ANSWER?

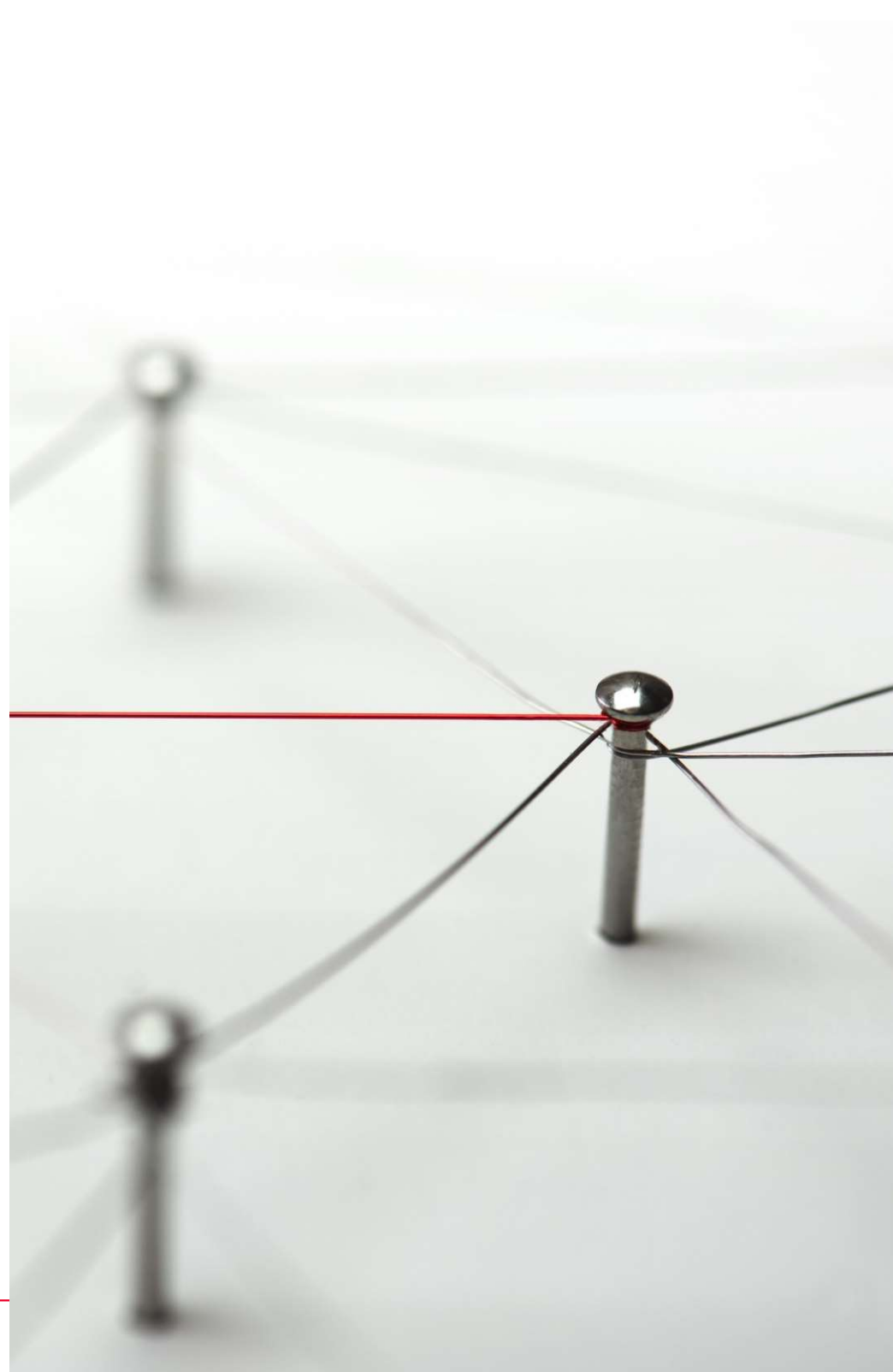
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| OVERVIEW

- Tax Dispute Process
 - Audit
 - Appeals
 - Litigation
- Choice of Forum Considerations
 - Tax Court vs. Other Options
 - Factors to Weigh in Deciding Forum
- Types of Cases
- In Practice
- Trial Pointers



TAX DISPUTE PROCESS



Why Start Here?

- It is important to understand the entire “arc” of a tax controversy
- Step 1: what does your client want to achieve?
- Step 2: at which phase of the process is that most likely to be achieved?
- Step 3: what do we need to prove to be successful at that stage →
START NOW!
 - Consistency is key
 - Make sure that your position is clear, well thought out and supported at every stage – documents travel from stage to stage
 - Get your documents and witnesses lined up as soon as possible, no surprises

| TAX DISPUTE PROCESS



Audit Basics

- Begins with a letter notifying taxpayer that their tax return has been selected for examination
- Notification letter is typically followed with an Information Document Request (“IDR”). IDRs are the revenue agents’ “informal” device for gathering information
 - (IDRs don’t look terribly informal)
- Taxpayer responds to the IDR, after which a meeting is scheduled with the revenue agent to discuss taxpayer’s responses and potential issues
 - Taxpayer’s first opportunity to start framing the issues
- See *generally* IRM [4.10.1](#) and [4.10.2](#) for more details on the Service’s responsibilities and beginning of audit procedures
 - Do not hesitate to enforce these requirements!

| TAX DISPUTE PROCESS



Audit Basics

- Follow-up IDRs may be issued requesting clarification of a prior response or new information
- If the revenue agent feels like they are not getting complete cooperation, they may issue summonses (authorized under IRC 7602) to taxpayer and/or third-party record-keepers
- Revenue agent may also request a taxpayer interview
- When revenue agent is satisfied with the information provided, they will write up a report
 - The report could propose adjustments to income, a refund to the taxpayer, or no adjustment at all
- See *generally* IRM [4.10.8](#) for an overview of the Service's closing procedures

Appeals

- Conclusions reached by the IRS exam team can be administratively appealed to the “IRS Independent Office of Appeals”
- Appeals Office is the only level of appeal within the IRS
- Must appeal within the scope of tax laws, not appeal on the basis of other grounds (e.g., constitutional, political, etc.)
- To appeal, can file a small case request or a formal written protest
 - Follow timing deadlines for filing as laid out in the instructions
 - When a formal protest is required, include all pertinent information

| TAX DISPUTE PROCESS



Appeals

- Appeals conferences can be conducted with the taxpayer or their authorized representative:
 - In person,
 - Through correspondence, or
 - By telephone or video conference
- Only attorneys, CPAs, or enrolled agents may represent a taxpayer before Appeals
- Other common issues on timing and expectations are addressed on the IRS [website](#)
 - IRS commitments
 - Taxpayer and representative responsibilities
 - Timing expectations

| TAX DISPUTE PROCESS



Reaching Litigation

- If the Appeals process is unsuccessful or if the taxpayer chooses to forego Appeals, a case can be taken to court
- What court the taxpayer chooses will have various benefits and consequences

CHOICE OF FORUM CONSIDERATIONS



| CHOICE OF FORUM CONSIDERATIONS

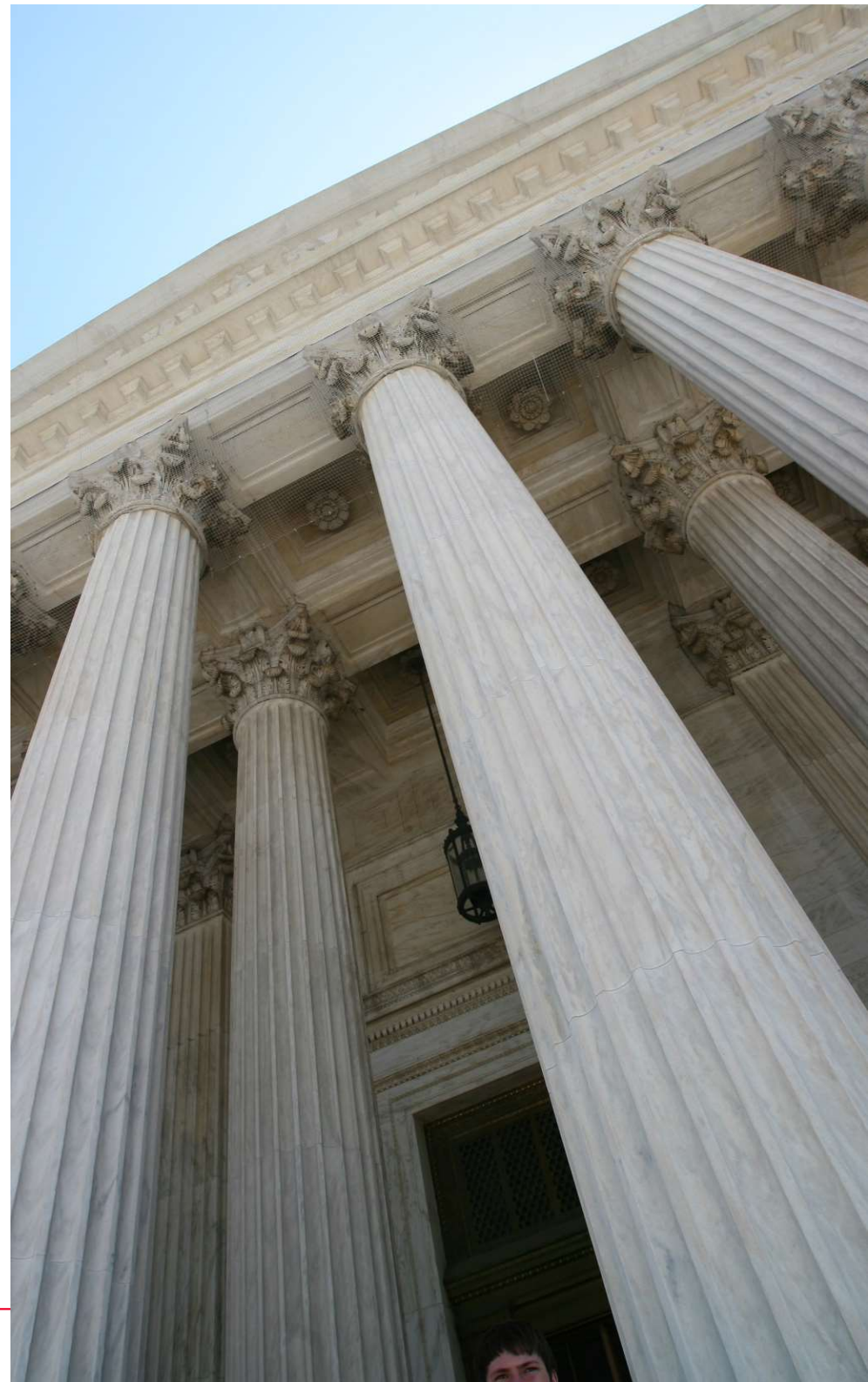
Overview on Court Selection

- Possible venues
 - Tax Court
 - District Courts
 - Court of Claims
 - Bankruptcy Courts
- Things to consider
 - Precedent
 - Legal decisionmaker: judge vs. jury
 - Judicial experience in tax disputes
- See [Choice of Forum in Federal Civil Tax Litigation](#) by Thomas D. Greenaway

CHOICE OF FORUM CONSIDERATIONS

Tax Court

- Prepayment actions only – can file a petition upon receipt of a notice of deficiency (the “90-day letter” or “ticket to Tax Court”)
- Judges are experts in tax
- Civil cases only, and the court has a limited jurisdiction as expressly authorized by Congress
- Judges decide the outcome; no jury option
- Follows the precedent of the Court of Appeals for the circuit to which the case would be appealed.
 - *Golsen v. Comm’r*, 54 T.C. 742 (1970)
- 90-day deadline to petition the Tax Court; 150 days if overseas
 - [IRC 6213\(a\)](#)



CHOICE OF FORUM CONSIDERATIONS

District Courts

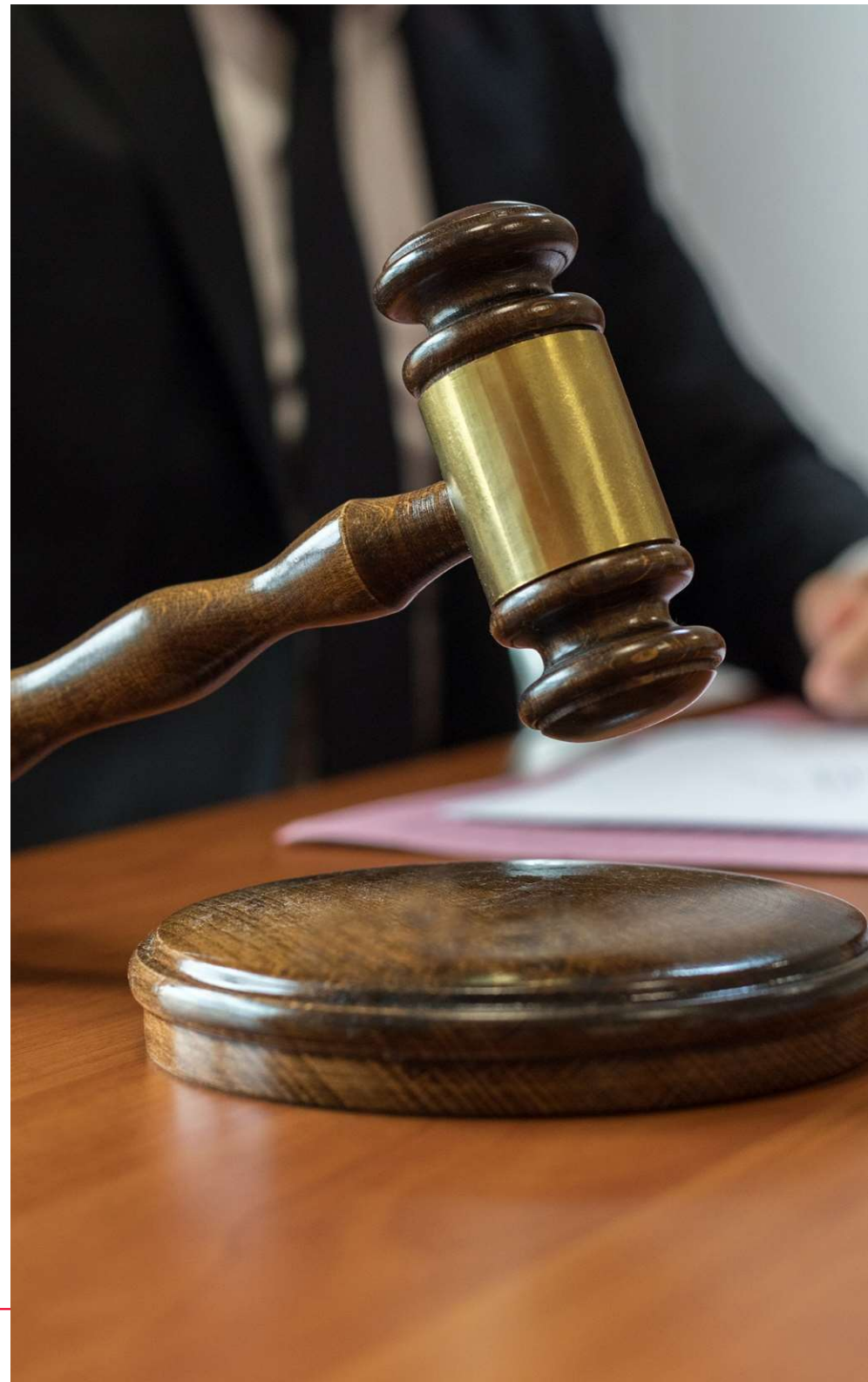
- Refund actions only – must pay the tax and then sue for a refund to litigate here
- Must adequately develop refund claim at the administrative level
 - Generally, the court will not entertain any “variances” from the refund claim as filed (limited exceptions). [Treas. Reg. § 301.6402-2\(b\)\(1\)](#) . See also [“The Variance Doctrine: An Important Variable To Consider When Drafting Refund Claims”](#) by Megan Brackney
- Not an option for nonresident aliens
- Judicial experience with tax issues is limited
- Option to have a jury be the ultimate decisionmaker
- Two years from notice of claim disallowance to file a refund suit, or 6 months without a response → remember statute of limitations for filing refund claims!



CHOICE OF FORUM CONSIDERATIONS

Court of Federal Claims

- Refund actions only – same standards and considerations as District Court actions
- No jury option; case will be decided by the judge in a bench trial
- Judicial experience with tax issues varies, but can be substantial
- Tends to be the “slowest” of the venues



| CHOICE OF FORUM CONSIDERATIONS



Soft Factors

- Does your client want their trial in their home state?
 - Easier access to witnesses and documents, but also easier access for media/onlookers
 - District Court in taxpayer's home jurisdiction
 - Tax Court can be local or in DC (taxpayer choice)
 - Court of Federal Claims generally hears cases in DC, but will travel
- Scope of discovery
 - Tax Court is less formal; discovery tends to be less burdensome (and thus less costly)
 - No national jurisdiction to subpoena witnesses if in District Court
 - Tax Court and Court of Federal Claims have national jurisdiction

CHOICE OF FORUM CONSIDERATIONS

Government Counsel

- Court of Federal Claims – DOJ Tax, Court of Federal Claims Section
- District Court – DOJ Tax, geographically-based section
- Tax Court – IRS Chief Counsel trial attorneys

Precedent

- Court of Federal Claims appeals to the Federal Circuit
- District Court appeals to the Circuit court covering the geographic location of the trial court
- Tax Court – *Golsen* rule



CASES IN PRACTICE



| TYPES OF CASES



- Valuation cases
- Various substantive issues
 - Federal Gift Tax Challenges
 - Breach of Fiduciary Duty Litigation
 - Estate Tax Disputes
- Considering precedent is very important in deciding which forum is best

| PRACTICAL EXAMPLE

Formula Clauses

- Formula clauses limit the tax exposure of a valuation controversy when the value of a gift or sale is not easily known
- Two kinds of formula clauses:
 - Valuation formula transfer clauses (or “defined value clauses”)
 - Valuation formula allocation clauses

Wandry v. Commissioner, T.C. Memo 2012-88

- First case in which a court held a defined value clause valid
- Facts:
 - Husband and wife created LLP
 - Contributed cash and marketable securities
 - Sought to gift partnership interests to their children
 - On advice of their lawyer, they gave gifts in a **specific dollar amount** vs. giving a set number of partnership units. This continued when the taxpayers created a family business and still gave the gifts via dollar amount instead of units in the business.
 - CPA prepared Forms 709 reporting the gifts at the agreed upon dollar amount

Wandry v. Commissioner

- On review, the IRS concluded that the values of the gifts given were greater than the amounts reported on the taxpayers' Federal gift tax returns
- IRS argued that, in effect, the taxpayers actually gave fixed percentage interests in the gifted entities and the “adjustment clause,” providing for the percentage of interests given to change based on value, was against public policy
- Taxpayers argued the provisions in the gifts stood and did not violate public policy

Wandry v. Commissioner

- The Tax Court:
 - Distinguished the case from precedent where gift savings clause was invalidated
 - Found that the taxpayers’ “consistent intent and actions prove that dollar amounts of gifts were intended,” and not fixed ownership percentages
 - Held that there was “no well-established public policy against formula clauses”
- IRS Response: Action on Decision (AOD) recommending non-acquiescence with the holding of *Wandry*

Playing Out the Case

- Client does not want to pay gift tax
- Exam team, given AOD, cannot accept defined value clause
- Appeals is supposed to consider “hazards of litigation,” but generally has not honored such clauses, at least anecdotally
- Options: **payment** (preserves option for a refund suit) or **Tax Court** petition
 - Compare cost of litigation to amount of tax
 - Consider potential impact of penalties
 - Recovery available from other sources?
 - Venue?

TRIAL POINTERS



| CONSIDERATIONS FOR TRIAL



- Seek agreement on documents and facts early and often
 - Are the facts so undisputed that summary judgment is an option?
 - Could save taxpayer considerable expenses, if so
- Start identifying and preparing witnesses as soon as possible, including experts
 - In the Tax Court, the expert's written report is considered their direct testimony
 - Are there experts the government is likely to call? What will they likely say? Should/can you depose them?
- Consider what other professionals might need a seat at the table
 - Accountants, valuation experts...know the difference between consulting versus testifying experts

| CONSIDERATIONS FOR TRIAL

- Understand who has the burden of proof on which issues
 - Usually the taxpayer
 - Switches to the government on penalties and additions to tax
- Work backwards
 - What facts do you need to prove to win?
 - Which documents and/or witnesses are needed to prove them?
- Never underestimate the ability for things to go wrong
 - Witnesses are human – they get nervous, forget things, and occasionally become ill or die
 - Technology is fickle – always have a backup plan
- Remember that judges and juries (and counsel!) are people too
 - Consider tone, level of cooperation, responsiveness

| CONSIDERATIONS FOR TRIAL

Know your audience

- Does your judge or jury know the area of law or the specific industry at issue?
- Pay attention to the questions that the judge asks witnesses
- Would a picture/demonstrative help tell your story to visual learners?

Know the court's rules and culture

- Consider local or co-counsel if you're new to the forum

Prepare, prepare, prepare

- When you think you've got everything down, prepare some more
- Run your arguments and presentation by colleagues who are not involved in the case

| TO SETTLE OR NOT TO SETTLE



- Ultimately your client's call – remember what it was that they wanted to achieve in the first place
- Consider whether the issue is recurring such that a judicial opinion is important
- What are the potential cost savings of stopping now and not proceeding further?
 - Weigh against what might be conceded in a settlement
- Consider whether there are any additional facts that might be out there that could still benefit your client
- Would proceeding to trial cause your client significant stress or bad PR?
- Even if you win at trial, is the government likely to appeal?



QUESTIONS?



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| HELPFUL REFERENCES

<https://www.irs.gov/government-entities/federal-state-local-governments/appeals-process>

<https://www.irs.gov/pub/irs-pdf/p5.pdf>

<http://www.uscfc.uscourts.gov/faqs>

http://www.cofc.uscourts.gov/sites/default/files/rules_20220718.pdf

[4.10.1 Overview of Examiner Responsibilities | Internal Revenue Service \(irs.gov\)](#)

[4.10.2 Pre-Contact Responsibilities | Internal Revenue Service \(irs.gov\)](#)

[4.10.8 Report Writing | Internal Revenue Service \(irs.gov\)](#)

[Appeals Process | Internal Revenue Service \(irs.gov\)](#)

[What to Expect from Appeals | Internal Revenue Service \(irs.gov\)](#)

[Federal Rules of Bankruptcy Procedure | United States Courts \(uscourts.gov\)](#)

THANK YOU!

