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# Settling Cases, Deficiencies and Refunds

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# SETTLING CASES, DEFICIENCIES AND REFUNDS*

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Most income tax controversies originate in the field audit of income tax returns. The field auditor, the revenue agent, is the fact finder for the Internal Revenue Service.

*Dealing With Revenue Agent*

If an agreement is reached between the revenue agent and the taxpayer's representative, the result is reflected in Treasury Form 870, setting forth the amounts of the deficiencies, penalties, if any, and overassessments. Since the revenue agent's report is subject to review by the Review Section of the Audit Division, there is considerable importance in having the tax computation carefully checked before the execution of Consent Form 870 by the taxpayer. If any correction is made by the Review Section after the examining officer's report is submitted, it becomes necessary to have a new waiver form prepared for execution by the taxpayer. In some circumstances, the changes may be found sufficiently complicated to deserve review approval by the Review Section prior to acceptance by the taxpayer and his counsel. While this is a departure from established procedure, the Audit Division has authority to follow such a course.

In the case of examinations of returns of corporations which customarily have the accounts audited by certified public accountants, there is an increasing tendency for the revenue agents to conduct the principal part or perhaps all of the examination by reference to the working papers of the accountant, if the corporation's officials and the accountants concur in such procedure. The practical effect is to shorten the time required by the field agent for the completion of his examination. The practice is subject to objection in some instances unless the working papers thus made available to the examining agent are restricted to those papers which have a bearing upon the computation of taxable income and exclude papers dealing with confidential activities of the corporation which have no bearing on the determination of tax-

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able income otherwise adequately shown in the principal working papers.

*Dealing With Group Supervisor*

In the event of failure of a settlement with the field agent, the examiner sends in a preliminary report showing his proposed adjustments to income and affording a period of ten days within which the taxpayer or the taxpayer's representative may request an informal conference. Upon such request, the case is assigned to a group supervisor by the conference coordinator. Such assignment may be to a group supervisor other than the one under whose direction the examiner is assigned regularly. In such cases, the intention is to avoid a conference being held by the group supervisor from whom the examining agent may have received instructions or advice relative to the disputed adjustments. This course of action is apparently advisable, though it should be unnecessary to refer the problem to a different group supervisor. A group supervisor who is properly qualified to hold such position should be capable of independent judgment and decision whether or not he has given preliminary advice to the examining agent. However, the assignment of the case to a different group supervisor offers some measure of protection against possible bias by a group supervisor whose advice has been adopted in the proposed adjustments.

The group supervisor's authority is superior to that of the examining agent. Ordinarily his decisions on questions of fact are approved fully by the Review Section. A decision by the group supervisor will be approved where the same conclusion by the field examiner without action by the group supervisor might be overruled or returned to the examiner for reconsideration and possible adjustment. While this statement is not subject to proof and may not be important, it is evident that more proposed settlements by field examining officers are adjusted in review than is experienced in cases of settlements effected by group supervisors.

In event of failure of settlement with the group supervisor, a notice of proposed adjustments will be mailed to the taxpayer. Such notice allows a period of thirty days within which a protest may be filed. Upon appropriate application, an extension of such thirty day period will ordinarily be granted.

*Should Case Be Taken to Appellate Within Pre-90-Day Status?*

At this point, there is presented a problem for an important decision on behalf of the taxpayer regarding the procedure to be followed. The filing of a protest causes the proceeding to be forwarded to the Appellate Division which operates under the general direction of the Regional Commissioner. The pertinent question is whether it is desirable to have the case taken to the Appellate Staff at this stage of the proceeding. Quite likely it may be found desirable to avoid such status until the case has proceeded to a litigation status.

As a general policy, if a case is to be taken to the Tax Court, if court action becomes required, it is advisable to file a petition to the Tax Court before attending a conference at the Appellate Division. Taking a case to the Appellate Staff in the pre-90-day status is likely to result in the lack of certain advantages which may frequently be expected after the case is docketed with the Tax Court.

It is suggested that there are about three principal factors favoring avoidance of a conference at the Appellate Staff until after docketing the case with the Tax Court, rather than conferring during the pre-90-day period. First, the imminence of actual trial before the court places more pressure on the Staff, and also on the taxpayer's counsel, to effect a settlement. There is less apparent time for unnecessary bickering and delays. Second, the chief counsel's representative ordinarily participates in the conference after the case is docketed. While such representative does not have direct settlement authority, his qualifications for judging trial possibilities may help to define and narrow the differences between the parties. Third, generally of lesser importance, but not to be disregarded, there is more risk that new issues involving increased deficiencies will be raised by the Staff in pre-90-day proceedings than after the case is docketed with the Tax Court. After the case is docketed, the burden of proof is on the Commissioner with respect to new issues on which he bases his motions for increased deficiencies.

*Exceptions*

As for most general policy rules, there are numerous exceptions to the procedural policy indicated above. The principal exceptions are outlined below:

(a) The amount involved may be too small to justify the expense of Tax Court action. In such cases, the possibility of obtaining some relief justifies taking the case to the Staff without first docketing it with the Tax Court.

(b) The proposed deficiency may be so arbitrary that no serious doubt will exist about the probability of obtaining acceptable corrective action by the Staff.

(c) The taxpayer may be unwilling to have his tax and financial affairs exposed to the publicity which may be incident to court action. Such is an unfortunate situation but is apparently less hazardous than taxpayers are sometimes inclined to assume. Nevertheless, in any case in which the taxpayer is convinced that the possible publicity of court action will prove to be detrimental to his best interests, it is better to take the case to the Appellate Staff than to concede the deficiency without further contest.

(d) If the case is to be taken to a tribunal other than the Tax Court, it may be found advisable to appeal to the Staff by filing a protest without docketing the case with the Tax Court. The action before the Staff might be acceptably successful. In any event, the action before the Staff can serve as a practice trial of the case which may serve to bring out essential points which had previously escaped notice. If so, the benefit of such development will be obtained in the proceedings in the subsequent court action, if no settlement is reached with the Staff.

(e) The case may involve a single issue which is already involved in another case pending before the Tax Court. If the decision of the Tax Court is expected to dispose of the issue, arrangements may be available for deferring action until such other case has been finally decided. Such deferment may also be found available at the audit level, making it unnecessary to take the case to the Appellate Staff.

(f) Finally, there is the too common situation in which there are prospects for a settlement on a basis which is substantially equivalent to the anticipated cost of litigation. This course of action has been the subject of some criticism on the basis that such a settlement is not only

> unfair, but tends to develop a custom under which all taxpayers having incomes involving controversial features must expect to pay more than their shares of the income tax. The cold fact remains, however, that there is a point beyond which it becomes poor business to carry a case into litigation.

The procedures change from time to time, making it essential to keep abreast of developments affecting the course of action to be followed.

Since 1938, settlement authority in docketed cases has been lodged in the Appellate Division (and its predecessor, the Technical Staff). Prior to that time, settlement authority was also held by the Chief Counsel.

In connection with the conference at the Appellate Staff on a case which has been docketed with the Tax Court a draft of a proposed stipulation of facts should be submitted as a basis for the discussions. Such action serves to keep the conference centered on the relevant facts and issues. If no settlement is reached, the proposed stipulation may be used in part in the trial action.

*Some Post-Reorganization Trends*

Following the reorganization of 1952, there developed an apparent official attitude that revenue agents should be especially subject to suspicion as to their integrity. Evidently this arose out of the exposure of frauds at the top level in the Washington office. There was no basis, as far as any published record shows, for any assumption that corruption existed among the field agents and employees. Nevertheless, official policies were adopted requiring severely close checks on the official and personal conduct of revenue agents and employees. There is little doubt that this had a detrimental effect on the morale of internal revenue agents generally. Revenue agents engaged in audits of income, estate and gift tax returns and determinations of tax liabilities are of professional classification whether or not they hold degrees or certificates as lawyers or certified public accountants. The unwarranted and widespread public view during the latter part of the year 1951 that there was wholesale corruption among the agents and employees of the Bureau of Internal Revenue was the subject of a pointed editorial in the issue of the *Indianapolis Star* of December 9, 1951, a portion of which is quoted as follows:

GET THE CULPRITS, NOT THE CROWD

> During recent weeks a great deal of criticism has been directed at the U. S. Internal Revenue Bureau. The nation has been shocked as witness after witness has disclosed instances of bribery and tax fraud "fix" cases. No doubt now remains that the income tax scandals are a smelly mess, but the public and too many newspapers have jumped to the conclusion that a rotten apple has corrupted the whole barrel. Nothing could be farther [sic] from the truth. Instead of getting the individual culprits, we have been shooting at the crowd. This criticism and wholesale indictment of the entire Internal Revenue Department is unfair and unjust. It follows the usual pattern of American public reaction to conclude that all bankers are crooks when one banker turns up as an embezzler.
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> . . . . A small group of only 57 bribe-taking political leeches have besmirched the reputations of thousands of men and women who resent dishonesty just as much as any other honest citizen. It isn't fair and it isn't just to condemn thousands for the dishonesty of a few, and yet that has been the effect of most of the comment to date — that of our own included.
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> . . . . So in the interest of fair play and common decency, we believe that the people of Indiana should stop, look and listen before they hurl general charges at the Internal Revenue Bureau. Get the individual culprits. Get them good and punish them severely. This goes for both the men who gave the bribes, as well as the officials who accepted them. But let's quit shooting at the crowd. Some very fine and completely innocent citizens have been cruelly wounded by indiscriminate blasting at the crowd.

Incident to the toughening official attitude following the 1952 reorganization, there followed a corresponding increase in the severity of the official attitude, generally, in the determinations of tax liabilities. The result has been a substantial increase in the volume of tax cases carried to the courts. However, this situation is not without precedent. That a legalistic rather than an administrative approach to the interpretation of tax laws is a serious cause of concern and was such at an earlier time is indicated by the fact that in 1927 the Secretary

of the Treasury, reporting to the Joint Committee on Internal Revenue Taxation on income tax administration, noted that — "The collection of revenue is primarily an administrative and not a judicial problem. As far as the Federal income tax is concerned, a field of administration has been turned into a legal battlefield."

Indications are that the official status of revenue personnel has been improved under the administration of the present Commissioner of Internal Revenue.

*Refund Claims*

In a proceeding under a claim for refund the taxpayer has no right to appeal to the Tax Court unless the Commissioner determines a deficiency. The procedure at the audit level is the same as for contesting against a deficiency. However, in the event of a disagreement, there is no question as to whether to file a petition with the Tax Court prior to a conference at the Appellate Staff unless a deficiency has been determined by the audit section.

A claim for refund must be regarded as an invitation to the revenue agent to do his best to reduce the claim or even to convert the action to an assessment of a deficiency. Consequently, it is important to give close attention to the possibilities of other adjustments when considering the filing of a refund claim other than a claim based upon a determination of tax by the Service or, as may become necessary, to protect the taxpayer against the expiration of the period of limitations governing the time within which the claim may be filed.

The problems incident to filing and pursuing a claim for refund are too varied to be covered in a discussion of the scope here attempted. The most important factor is to be reasonably certain that an overpayment exists before filing a claim.