

Office of Chief Counsel
Internal Revenue Service
Memorandum

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to:
Area Counsel (Natural Resources & Construction) (Large & Mid-Size Business)

from: Deborah A. Butler
Associate Chief Counsel (Procedure and Administration)

subject: Ex Parte Communications With Appeals

This Chief Counsel Advice responds to your request for assistance dated August 29, 2006. This advice may not be used or cited as precedent.

LEGEND

Taxpayer =
LMSB =

Area Counsel =

Cycle 1 =

Cycle 2 =

Date 1 =

Date 2 =

Date 3 =

Appeals Official 1 =

Appeals Official 2 =

ISSUE

Whether memoranda sent to certain Appeals officials by LMSB and Area Counsel regarding the failure to follow prescribed procedures relating to the post-Appeals mediation process and other perceived errors resulting in a proposed settlement, including the full concession of penalties by Appeals, while the case was still open in Appeals, violated the restrictions on ex parte communications.

CONCLUSION

Both the LMSB memorandum and the Area Counsel memorandum are prohibited ex parte communications under Rev. Proc. 2000-43. The LMSB memorandum goes beyond ministerial, administrative or procedural matters and addresses the substance of the issues or positions taken in the case. Although the content of the Area Counsel memorandum may be permissible in certain contexts, in this case, the memorandum was unsolicited and its language and tone appear to be intended to influence Appeals rather than advise Appeals. Additionally, the two memoranda were sent to Appeals before the proposed settlement was finalized. Thus, since the issues in question were still open and under consideration by Appeals, and the Taxpayer/representative were not given an opportunity to respond to the two memoranda, they violated the restrictions on ex parte communications with Appeals as implemented by the revenue procedure.

FACTS

Taxpayer's Cycle 1 taxable years were assigned to two Appeals Team Case Leaders (ATCL) for review. Certain issues in Cycle 1 were unresolved during the regular Appeals process and post-Appeals mediation, so a notice of deficiency was issued to the Taxpayer. The same ATCLs were assigned to review the Taxpayer's Cycle 2 taxable years. As was the case with respect to Cycle 1, certain issues were unresolved during the regular Appeals process and the Taxpayer once again requested post-Appeals mediation. A different ATCL was assigned to handle this phase of the case on behalf of Appeals because the ATCL with overall responsibility for the case declined to participate in the post-Appeals mediation process for a variety of reasons. Instead of going forward with the post-Appeals mediation process, the newly-assigned ATCL decided to settle the case over the objection of the Area Counsel attorney who had been advising Appeals during the regular Appeals process, the LMSB examination team and the ATCL with overall responsibility for the case. The proposed settlement included a full concession of the penalties by Appeals.

On Date 1, the ATCL with overall responsibility for the case sent a memorandum to Appeals Official 1 discussing the flaws in the proposed settlement and requesting that Appeals reconsider the concession of the penalties. On Date 2, LMSB sent a memorandum to Appeals Official 1 communicating its formal dissent to the proposed settlement, especially the full concession of the penalties, and requesting that the proposed settlement be reversed. On Date 3, Area Counsel sent a memorandum to Appeals Official 2 providing "a legal analysis supplement" to the two memoranda

mentioned above. Area Counsel's memorandum discussed various defects with the process and the proposed settlement, such as the failure to follow the prescribed procedures regarding post-Appeals mediation, important facts that were not considered, erroneous assumptions that were relied upon, and legal analyses that were incorrect. The Area Counsel memorandum recommended that the proposed settlement be withdrawn by Appeals and that the issues be reconsidered by a panel of ATCLs who have not been previously involved in the case and that the examination team be given the opportunity to participate in the post-Appeals mediation process so that they could consider and rebut any new issues or facts presented by the Taxpayer.

LAW AND ANALYSIS

Section 1001(a)(4) of the Internal Revenue Service Restructuring and Reform Act of 1998 directed the Commissioner to implement a plan to prohibit ex parte communications between Appeals and other Service employees, "to the extent such communications appear to compromise the independence of appeals officers." To fulfill that mandate, the Department of the Treasury and the Internal Revenue Service issued Rev. Proc. 2000-43, 2000-2 C.B. 404. The revenue procedure sets forth limitations on ex parte communications and addresses the scope of permissible ex parte communications.

For purposes of Rev. Proc. 2000-43, ex parte communications are communications that take place between Appeals and another Service function without the participation of the taxpayer/representative. Rev. Proc. 2000-43, Section 3, Q&A-1. In general, ex parte communications between any Appeals employee and employees of other IRS offices are prohibited to the extent that the communications appear to compromise the independence of Appeals. *Id.* The revenue procedure contains several exceptions to this general rule, however. For example, Rev. Proc. 2000-43, Section 3, Q&A-5, provides an exception for communications that involve ministerial, administrative, or procedural matters and do not address the substance of the issues or positions taken in the case. Q&A-5 goes on to state, however, that communications with the originating function¹ that extend beyond the above-described matters and address the substance of the issues or positions taken in the case are prohibited unless the taxpayer is given the opportunity to participate.² Examples of prohibited ex parte communications by or

¹ The term "originating function" means an organization within the IRS that makes determinations that are subject to the Appeals process. For purposes of the revenue procedure, the term includes the Examination, Collection, Service Center, International and Tax Exempt/Government Entities functions, or their successor organizations. Rev. Proc. 2000-43, Section 3, Q&A-20.

² The phrase "opportunity to participate" means that the taxpayer/representative will be given a reasonable opportunity to attend a meeting or be a participant in a conference call between Appeals and the originating function when the strengths and weaknesses of issues or positions in the taxpayer's case are discussed. The

with the originating function include discussions about the accuracy of the facts presented by the taxpayer and the relative importance of the facts to the determination, discussions of the relative merits or alternative legal interpretations of authorities cited in a protest or in a report prepared by the originating function, and discussions of the originating function's perception of the demeanor or credibility of the taxpayer/representative. Id.

In the instant case, LMSB sent a memorandum to Appeals Official 1 and Area Counsel sent a memorandum to Appeals Official 2, both of whom were higher in the Appeals management chain than the ATCLs who were considering the Taxpayer's Cycle 2 taxable years. The LMSB memorandum apparently was sent pursuant to existing formal dissent procedures "for Compliance to voice their concerns about an Appeals settled case." The Area Counsel memorandum provided additional legal analysis in support of the LMSB memorandum and a memorandum that was sent by the ATCL with overall responsibility for the case. Neither Appeals Official 1 nor Appeals Official 2 requested legal advice from Area Counsel concerning this matter.

With respect to the LMSB memorandum, in addition to pointing out a few procedural defects, the bulk of the memorandum discusses several factual errors made by the newly-assigned ATCL in concluding that the penalties should be conceded in full, as well as the weight to be given to various facts. The memorandum can also be read as commenting on the demeanor or credibility of the Taxpayer. Moreover, the LMSB memorandum requests that the proposed settlement be reversed, and given that it is a dissent memorandum, was intended to influence Appeals. Hence, the LMSB memorandum is an ex parte communication of the type that is prohibited under Rev. Proc. 2000-43, Section 3, Q&A-5, unless an exception applies.

Similarly, although the Area Counsel memorandum mentions certain procedural defects in connection with the post-Appeals mediation process, the memorandum focuses on the litigation hazards relating to the penalties and the newly-assigned ATCL's evaluation of those hazards. Of necessity, the Area Counsel memorandum addresses factual and legal errors made by the newly-assigned ATCL. Unlike the LMSB memorandum, however, the Area Counsel memorandum does not advocate outright reversal of the proposed settlement but rather recommends that a panel of ATCLs who have not been previously involved in the case be assembled to reconsider the proposed settlement.

To achieve the desired balance between ensuring the independence of Appeals and preserving the role of Appeals as a flexible administrative settlement authority operating within the Internal Revenue Service's overall framework of tax administration responsibilities, the revenue procedure retains the ability of Appeals to obtain legal

taxpayer/representative will be notified of a scheduled meeting or conference call and invited to participate. Rev. Proc. 2000-43, Section 3, Q&A-21. If the communication is in writing, the written document will be shared with the taxpayer/representative and the taxpayer/representative will be given an opportunity to respond to it.

advice from the Office of Chief Counsel. Communications between Appeals and Counsel are addressed in Rev. Proc. 2000-43, Section 3, Q&A-11. Specifically, the revenue procedure provides that Appeals employees should not communicate ex parte regarding an issue in a case pending before them with Counsel field attorneys who have previously provided advice on that issue in that case to the IRS employees who made the determination Appeals is reviewing. Counsel will assign a different attorney to provide assistance to Appeals. Rev. Proc. 2000-43, Section 3, Q&A-11. Counsel adhered to that requirement in this case, inasmuch as different field attorneys provided advice to Appeals and to the examination team.

Q&A-11 also cautions Appeals employees that, while they may obtain legal advice from the Office of Chief Counsel, they remain responsible for independently evaluating the strengths and weaknesses of the specific issues presented by the cases assigned to them, and for making independent judgments concerning the overall strengths and weaknesses of the cases and the hazards of litigation. Moreover, Q&A-11 provides that consistent with this assignment of responsibility, Counsel attorneys will not provide advice that includes recommendations of settlement ranges for an issue in a case pending before Appeals or for the case as a whole. In the instant case, although the Area Counsel memorandum discusses facts that Counsel believes should have been but were not considered, erroneous assumptions that were relied upon, and flawed legal analyses, resulting in the inaccurate evaluation of litigation hazards in Counsel's view by the newly-assigned ATCL, the memorandum stops short of recommending a settlement range for the penalties. Instead, the Area Counsel memorandum strongly indicates that full concession of the penalties by Appeals is not warranted but merely recommends that the proposed settlement be withdrawn by Appeals and that the issues be reconsidered by a panel of ATCLs who have not been previously involved in the case and that the examination team be given the opportunity to participate in the post-Appeals mediation process so that they could consider and rebut any new issues or facts presented by the Taxpayer. Consequently, standing alone, the Area Counsel memorandum would not necessarily constitute a prohibited ex parte communication.

The Area Counsel memorandum cannot be evaluated in a vacuum however. In this regard, the Area Counsel memorandum states that it was submitted as a legal analysis supplement to the dissent that was previously submitted by LMSB and the memorandum sent by the ATCL with overall responsibility for the case. Thus, it is inextricably tied to the LMSB memorandum. Furthermore, while the Area Counsel memorandum arguably may have been permissible had it been sent in response to a request for advice by Appeals, even if the advice request from Appeals would have been prompted by the LMSB memorandum, the Area Counsel memorandum was in fact unsolicited. Moreover, its language and tone appears to have been designed to influence Appeals rather than simply to advise them. Accordingly, like the LMSB memorandum, the Area Counsel memorandum is an ex parte communication of the type that is prohibited under Rev. Proc. 2000-43, unless an exception applies.

As discussed previously, Rev. Proc. 2000-43, Section 3, Q&A-5, provides an exception for communications that involve ministerial, administrative, or procedural matters and do not address the substance of the issues or positions taken in the case. Q&A-5 goes on to state, however, that communications with the originating function that extend beyond the above-described matters and address the substance of the issues or positions taken in the case are prohibited unless the taxpayer is given the opportunity to participate. That exception is inapplicable here because both the LMSB memorandum and the Area Counsel memorandum go beyond ministerial, administrative, or procedural matters and unquestionably address the substance of the issues or positions taken in the case.

Another potential exception is set forth in Rev. Proc. 2000-43, Section 3, Q&A-26. Q&A-26 provides that the prohibition on ex parte communications does not apply to post-settlement conferences between Appeals and Examination. The rationale for this position is that the tax periods that are the subject of the post-settlement conference have been finalized. The participants are cautioned, however, to limit discussion to the results in the closed cycle. Discussion of the resolution of issues present in the closed periods does not jeopardize the independence of Appeals. In contrast, Q&A-26 further provides that any discussion that addresses open cycles of the same taxpayer should be postponed and the guidance set forth in the revenue procedure relating to ongoing disputes should be followed. Rev. Proc. 2000-43, Section 3, Q&A-26. This exception is not applicable in the instant case because the Taxpayer's Cycle 2 taxable years are still open and under consideration by Appeals.

Finally, a potential exception is set forth in Rev. Proc. 2000-43, Section 3, Q&A-16, which makes it clear that the Commissioner and others responsible for overall IRS operations, including Appeals, may continue to communicate ex parte with Appeals in order to fulfill their responsibilities. Specifically, the revenue procedure provides that in accordance with Code section 7803, the Commissioner is responsible for managing and directing the administration of the internal revenue laws and tax conventions to which the United States is a party. In the course of exercising that statutory responsibility, the Commissioner and those officials, such as the Deputy Commissioner Operations, who have overall supervisory responsibility for IRS operations, may communicate with Appeals about specific cases or issues and may direct that other IRS officials participate in meetings or discussions about those cases or issues, without providing the taxpayer/representative an opportunity to participate. Rev. Proc. 2000-43, Section 3, Q&A-16.

In light of Q&A-16, it is clear that IRS officials at a sufficiently high level in the organization are permitted to communicate ex parte with Appeals about specific cases and issues. Since the LMSB memorandum appears to have been sent to Appeals pursuant to dissent procedures currently in place between Compliance and Appeals, it would seem that the communication should fall within this exception. Similarly, because both the LMSB memorandum and the Area Counsel memorandum, at their core, were intended to call to the attention of Appeals upper management, who were not directly involved in the consideration of the Taxpayer's case, what LMSB and Area Counsel

executives believe to be serious factual, legal and procedural errors relating to the proposed full concession of the penalties in this case by Appeals, that in their view could potentially have a significant adverse effect on tax compliance beyond this specific case or Taxpayer, it likewise appears that the communications should fall within this exception. Unfortunately, notwithstanding the existence of policy arguments that could be made in favor of that result, as currently drafted, the revenue procedure does not support that conclusion. As previously stated, Q&A-16 identifies the Commissioner, Deputy Commissioner Operations, and other IRS officials who have “overall supervisory responsibility for IRS operations”, as persons who may communicate ex parte with Appeals. The signatories of the two memoranda in question, i.e., LMSB and Area Counsel, do not meet that criterion. Therefore, the LMSB memorandum and the Area Counsel memorandum constitute prohibited ex parte communications with Appeals under the revenue procedure.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

[REDACTED]

[REDACTED]

[REDACTED]



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