DEPARTMENT OF JUSTICE
TAX DIVISION

SETTLEMENT REFERENCE MANUAL

Co-Authors:
Mildred L. Seidman
John A. DiCicco
Deborah S. Meland

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INTRODUCTION

Civil tax controversies in the courts are resolved either by settlement or by judicial decision. Litigation and settlement are twin aspects of the Tax Division's role of contributing to the orderly and rational development of the tax law through the cases we litigate. This manual focuses on questions concerning resolution by settlement. The term settlement includes both compromises, where both parties are giving up something, and concessions, where the United States is giving up the case, or an issue in the case, and is not receiving anything in return.

Trial Attorneys play a pivotal role in the settlement process, although they do not have authority to settle cases – both points should be made clear to opposing counsel and the court when settlement is discussed. The laboring oar in settlement, as in every aspect of civil litigation handled by the Tax Division, rests in the hands of the Trial Attorney. Trial Attorneys are the best informed about the facts and law applicable to their cases, and their settlement recommendations are accorded great weight. The Trial Attorney has primary responsibility for evaluating the litigation potential (and, thus, the settlement potential) of the case at every stage of trial court litigation, and the Appellate Attorney has similar responsibility when a case is in the Court of Appeals. The Trial Attorney negotiates any proposed compromise or recognizes the propriety of concession, and prepares a memorandum justifying the recommendation to the person with authority to concede or compromise. If the settlement is approved, the

Trial Attorney is responsible for assuring that the settlement is implemented and that the Government gets all it bargained for.

This reference manual addresses, in *Part I*, policy and practical considerations that impact Tax Division settlements, in *Part II*, the authority to approve settlements and concessions in tax cases, in *Part III*, the settlement process, in *Part IV*, considerations in evaluating settlements, and in *Part V*, common issues that arise in settlements of tax cases. Collected in the Appendix are commonly referred to documents and model documents to provide further guidance. Included with this manual is an Appendix of documents which Tax Division attorneys may find useful, including a:

- Settlement Checklist
- Quick Reference Chart
- Flowchart of Compromise Process for Joint Committee
- Flowchart of Compromise Process for Associate A.G.

Trial Attorneys can use the model documents in preparing for settlement discussions, drafting a recommendation, and drafting documents to memorialize a settlement and implement its terms.

Except to the extent that binding authority is referenced (*e.g.*, in *Part II*, with respect to settlement authority), the discussion and suggested procedures in this Settlement Reference Manual reflect internal guidelines only and do not bind the Tax Division or create rights for any person.

I. POLICY AND PRACTICAL CONSIDERATIONS

A. Settlement Versus Litigation: in General

The Tax Division endeavors to litigate when appropriate, to concede when appropriate, and also to compromise when appropriate on terms that are just and in the Government's best interests. Accordingly, it is our settlement policy to concede a position that is erroneous. In all other instances, compromises is justified by litigation hazards or collectability concerns, or a combination of the two and in rare instances in accord with Tax Division Directive No. 116 (see discussion at I-B, *below*).

Admittedly, few cases are 100% winners, and many litigators estimate that, given the vagaries of our litigation system, most cases have a 10 to 15 percent risk of being lost due to some unforeseen or uncontrollable event. In general, the Tax Division does not consider the risk inherent in litigation as a basis for conceding 10, 15, or 20 percent. Settlements on such a basis encourage litigation of matters that could have been resolved administratively, and cost the Government far more in the long run. Likewise, the Tax Division does not settle cases based on nuisance value – *i.e.*, for a small amount that does not bear a relationship to litigation hazards or collectability concerns. To do so would encourage suits, no matter how baseless, with the expectation of receiving some amount by way of settlement and undercut the efficacy of the settlement structure within the IRS.

From the outset of a case and throughout its development, Trial Attorneys should consider the question of litigation or settlement. Trial Attorneys should continually reevaluate the desirability of settlement and whether alternative dispute resolution might be useful, taking into account factual and legal developments in the case. When evaluating the litigation and settlement posture of a case, all litigation hazards, including equities, must be taken into account.

B. Tax Division Directive No. 116

Tax Division Directive No. 116 provides a narrow exception to the general rule that settlement must be based only on the hazards of litigation and/or collectability concerns. Directive 116 recognizes that an analysis of litigation hazards should take into account the equities. Settlements based on limited collectability, by their very nature, take economic hardship into account. Under Directive 116, the Tax Division may settle a case, even if not warranted strictly on the basis of litigation hazards or collectability, if "litigation of the case will be detrimental to the goal of fostering voluntary compliance with our federal tax laws." Cases that fall within this exception are rare.

A settlement recommendation that relies on any basis other than litigation hazards or collectability must be referred through the Office of Review to the appropriate Deputy Assistant Attorney General for final action (unless normal settlement procedures require final action to be taken at a higher level).

C. The Need for Preparation

The basic principles applicable to litigation are equally applicable to settlement. Good preparation is the key to both. It is not possible to make a sound settlement recommendation without thoroughly preparing your case and having an understanding of both the facts and law. The surest way to obtain a good settlement is to do a good job preparing the case for trial.

Revenue Agents and Revenue Officers do not prepare their files with a view to litigation. They do not generally collect the names of all potential witnesses or make copies of all pertinent documents. The file ordinarily contains information deemed sufficient to warrant the assessment of tax or denial of the claim for refund. Much of the information is what the taxpayer has chosen to furnish and little of it has been verified.

Tax Division attorneys must take the raw administrative file and, using civil discovery, develop evidence necessary to present the Government's case effectively. Every step in the development of the evidence in a tax suit must be accompanied by a careful winnowing of legal theories – a continual search for sound legal principles.

D. The Need to Communicate with the IRS

In settlement, as in litigation, it is important to communicate with the Chief Counsel attorneys and the IRS. As the Trial Attorney who

has developed the case, you may obtain more factual information about a case than was available to the Chief Counsel attorney when the defense or suit letter was written. You should promptly advise the Chief Counsel attorney if newly discovered facts warrant a revision of the Government's litigating position, or the reevaluation of litigation hazards or collectability concerns. Also, the Trial Attorney should communicate with the IRS personnel who actually worked the case (or related cases) such as Revenue Agents, Special Agents, Engineering Agents, International Examiners, Technical Advisors, and Service Center personnel, who may have information that is not in the files. Moreover, talking with IRS personnel is particularly important in cases involving issues that arise not only in the year in suit, but also in subsequent years.

It is always advisable to talk with someone at the IRS or Chief Counsel whose position you disagree with, or do not understand, before committing your position to writing. You may have missed an important fact, or misunderstood a legal position. Only the Assistant Attorney General can accept an offer over the objection of Chief Counsel. *See* Tax Division Directive 139. Consequently, sometimes you must negotiate with Chief Counsel attorneys and IRS personnel just as you negotiate with opposing counsel.

E. Issue Settlements Versus Dollar Amount Settlements

In negotiating settlement of any multi-issue case, the Trial Attorney should know how much is involved in each aspect of the case

before discussing any issue with opposing counsel. A good starting point is the notice of deficiency, or the Revenue Agent Report ("RAR") statement of audit changes. Generally, in an issue settlement, either issues are traded, or one party concedes one or more issues and other issues are settled on a percentage basis. If there are two issues in a case, and one issue involves $5,000 and the second $100,000, it is not considered a 50-50 settlement if it is proposed that the taxpayer concede the first issue and the Government the second. Neither is it regarded as a 50-50 settlement where, on the issue which the taxpayer offers to concede, the Government is supported by the Tax Court and three courts of appeals, while on the issue which it is proposed the Government concede, there is no case directly on point and two conflicting lines of authority.

An issue settlement may be appropriate if the resolution of the issue(s) in suit will have continuing consequences in subsequent tax periods or as to other tax liabilities or other taxpayers. Consideration should be given to the dollars involved in those other years or taxpayers as well as the years in suit. Where the disputed liability is substantial or the taxpayer is in a trade or business, a settlement based on income adjustments – an issue settlement – is the norm. Among other things, an issue settlement obviates problems that might arise in determining loss or credit carrybacks and carryforwards involving the years in litigation. A percentage compromise of a deficiency assessment should be avoided, however, where the assessment was based on more than the issues that are being litigated – *e.g.*, an assessment based on agreed and unagreed issues.

A settlement may be based on an offer to accept a refund of a flat amount, plus interest. Thus, in a suit for a refund of $5,000, a taxpayer may offer to accept a refund of $2,000, plus interest. Flat-amount settlements are particularly appropriate in a relatively small-dollar case involving several issues, where the effort and delay in preparing a computation may not be justified and both parties have a pretty good idea of the tax dollars attributable to each issue. If the parties do not know or cannot agree on the tax amount attributable to an issue, a recomputation may be necessary in order to evaluate the proposed concessions. A flat-amount settlement is not appropriate if the resolution of the issue(s) in suit will have continuing consequences in subsequent tax periods or as to other tax liabilities or other taxpayers.

An issue settlement is always necessary if the issue(s) in suit have consequences or occur in subsequent years, or affect other taxes or other taxpayers. For example, if the issue is whether an expense was a capital expenditure or an ordinary expense, the evaluation of a settlement offer will require consideration of the capital vs. ordinary character of the expense, as well as whether capital loss carrybacks or carryovers have been allowed; whether depreciation deductions have been allowed in subsequent years; whether deductions allowed by settlement increase alternative minimum tax liability; and whether the deductions allowed by the settlement impact investment tax credits. For a further discussion of the issues that commonly arise in settlements, *see Part V.*

When settlement is based on collectability, the Trial Attorney should try to obtain all necessary financial information before beginning to negotiate. Negotiations over collectability often start with a statement by opposing counsel that his client is unable to pay any judgment the Government might obtain. The Trial Attorney should invite the taxpayer to submit the financial information necessary to document non-collectability. The information submitted should be verified by the IRS to the extent appropriate. Typically, the financial documentation should include (1) a completed Collection Information Statement (IRS Form 433-A or 433-B) and (2) copies of income tax returns for the prior five years. *See* *Part V-A*, for a fuller discussion of collectability settlements.

F. Concessions and the Trial Attorney's Role

If the Tax Division concludes that the Government's case lacks any merit whatsoever, the case should be conceded. Normally, the Chief Counsel will recommend concession of a meritless case in the defense letter. Where the Chief Counsel has not done so, the Trial Attorney may nevertheless identify law or develop facts that justify concession. If the Trial Attorney believes that the Government's position is erroneous, the attorney should bring the matter to a supervisor's attention, and if the supervisor agrees, speak with and then send a letter to the Chief Counsel requesting that the Chief Counsel reconsider the merits. The same procedure should be followed if the Chief Counsel recommends concession but the Trial Attorney believes that defense of the case is merited.

G. Things to Consider in General

Some cases are more appropriate for settlement than others, and in weighing the potential for settlement it is useful for the Trial Attorney to consider the various factors favoring and disfavoring settlement. Of course, just because factors favoring settlement exist, does not mean the taxpayer will make an offer that would be in the Government's best interests to accept. Similarly, the presence of factors that weigh against the likelihood of settlement does not mean that a case cannot or should not be settled.

1. Factors favoring settlement include the following:

- The case involves largely factual issues and the legal principles are well established (e.g., valuation cases, substantiation cases, trust fund penalty recovery cases);
- The case is legally and/or factually complex;
- A consensual resolution may lead to greater future compliance (*e.g.*, employee-independent contractor cases);
- The settlement would be based solely on collectability;
- There is the potential for jury nullification;
- The nature or status of a party to the dispute might influence the outcome of the litigation (*e.g.*, a sympathetic plaintiff);
- The parties have substantial litigation hazards; or
- The Government has an interest in avoiding adverse precedent that outweighs the benefit of proceeding with litigation.

2. Factors disfavoring settlement include the following:

- The taxpayer's case clearly has no merit (*e.g.*, certain tax protestor/defier suits);
- The case should be resolved on motion, such as a motion to dismiss or for summary judgment;
- The case presents an issue where legal precedent is needed, for example:

  (A) The issue involved is of national or industry-wide significance;

  (B) The issue is presented in a substantial number of cases; and/or

  (C) The issue is a continuing one with the same taxpayer;
- The importance of the issue(s) in the case makes continued litigation necessary despite some adverse precedent;
- The information presently available about the case is insufficient to evaluate meaningfully the issues involved or settlement potential;
- The Government has significant enforcement issues such as when the case is high profile and will involve publicity which could encourage taxpayer compliance, and/or the case involves a uniform settlement position (*e.g.*, shelter cases); or
- The case involves a non-frivolous constitutional challenge.

II. SETTLEMENT AUTHORITY

For purposes of determining settlement authority, the method(s) used to negotiate a particular settlement are not relevant. Regardless of whether the settlement is negotiated solely between the Trial Attorney and the taxpayer, or negotiated with the assistance of a mediator, or through a settlement conference ordered by a court, the authority to settle a Tax Division case does not change. "Judges are entitled to ask litigants to negotiate about the possibility of settlement, but cannot force them to settle." *United States v. LaCroix,* 166 F.3d 921, 922 (7th Cir. 1999).

When the Trial Attorney identifies for the litigants, courts and mediators, early and often, the person with whom settlement authority lies, the potential for misunderstanding is reduced. Misunderstandings and ignorance can be costly for litigants, and wasteful of the Government's resources. *See United States v. Walcott*, 972 F.2d 323 (11th Cir. 1992).

A. Attorney General, Deputy Attorney General, and Associate Attorney General

The Attorney General has broad and plenary settlement authority as to any matter referred to the Department of Justice, whether for prosecution or defense. See October 2, 1934, Opinion of the Attorney General. As the Seventh Circuit explained in *United States v. LaCroix,*

166 F.3d 921, 923 (7th Cir. 1999):

> Long ago the Supreme Court held that a purported settlement on behalf of the United States may be enforced if and only if the person who entered into the settlement had actual authority to compromise the litigation. *United States v. Beebe*, 180 U.S. 343, 351-55, 21 S.Ct. 371, 45 L.Ed. 563 (1901); *see also Stone v. Bank of Commerce*, 174 U.S. 412, 19 S.Ct. 747, 43 L.Ed. 1028 (1899); *Urso v. United States*, 72 F.3d 59 (7th Cir.1995). No one at HUD had actual authority to settle this case; and the persons in the Department of Justice who do have authority have declined to accept less than the United States' legal due. The district judge was required to respect that decision, made by those in the Executive Branch of government entitled to manage litigation.

Courts have imposed some limits on this authority, *Executive Business Media, Inc. v. U.S. Department of Defense,* 3 F.3d 759 (4th Cir. 1993), and upheld review of settlements under the Administrative Procedures Act (APA) to determine whether the agency has exceeded its authority or acted contrary to its own regulations, *United States v. Carpenter,* 526 F.3d 1237, 1242 (9th Cir. 2008).

All settlement authority resides in the first instance with the Attorney General, and is redelegated by regulation. All settlements that do not fall within the authority delegated to the Assistant Attorney General of the Tax Division must be acted upon by the Associate Attorney General. *See* 28 C.F.R. § 0.161 (authorizing Deputy Attorney General to exercise settlement authority of the Attorney General) *and* Order No. 1627-92 (Oct. 19, 1992) (delegating Deputy Attorney General's settlement authority to the Associate Attorney General).

Moreover, the Deputy Attorney General must be given notice of and an opportunity to consult in cases where a compromise or concession involves (1) any affirmative claim of $200,000,000 or more, (2) non-routine, sensitive, important, or novel legal issues, or (3) imposes a novel, sensitive, or unusually extensive conduct remedy or injunctive measure. In such cases, notification of the proposed action should be provided to the Associate Attorney General at least 15 business days before resolution. The Associate Attorney General will notify the Deputy Attorney General as appropriate. A Trial Attorney should consult with their supervisor if it appears that these requirements may apply to a particular case. The specific requirements appear at: http://www.justice.gov/usao/eousa/foia_reading_room/usam/title1/14mdoj.htm

B. Solicitor General

In any Supreme Court case, the Solicitor General must approve final action on an offer in compromise. In any appeal to any court authorized by the Solicitor General, any other action that would terminate the appeal, including settlement, may be accepted or acted upon only if the Solicitor General advises that the principles of law involved do not require appellate review. 28 C.F.R. § 0.163.

C. Assistant Attorney General

The Attorney General has delegated the following settlement authority to the Assistant Attorney General (28 C.F.R. §§ 0.160, 0.162, 0.164):

(1) To accept offers in compromise of claims asserted by the United States in all civil cases in which the difference between the gross amount of the original claim and the proposed settlement does not exceed $2,000,000 or 15% of the original claim, whichever is greater.

(2) To concede civil claims asserted by the United States where the gross amount of the original claim does not exceed $2,000,000.

(3) To accept offers in compromise of, or concede, claims against the United States where the principal amount of the Government's concession does not exceed $2,000,000, except that there is no monetary limitation on the Assistant Attorney General's authority in any case where the Joint Committee on Taxation has indicated it has no adverse criticism of the settlement or concession.

(4) To accept offers to compromise all nonmonetary cases.

(5) To reject offers in compromise in all cases.

The Assistant Attorney General has redelegated settlement authority as set forth in Tax Division Directive No. 139 *contained in* 28 C.F.R. Pt. 0, Subpart Y, app., "Redelegations of Authority to Compromise and Close Civil Claims," in those cases where Chief Counsel concurs in recommending acceptance or rejection of a settlement. Only the Assistant Attorney General can take action inconsistent with the recommendation of the Chief Counsel. In some cases, the Assistant Attorney General has delegated to the Deputy Assistant Attorney General the authority to approve a compromise that is based on consideration of "whether litigation of the case will be

detrimental to the goal of fostering voluntary compliance with our federal tax laws even though settlement is not justified by litigation hazards or collectability concerns." Tax Division Directive No. 116.

The "gross amount of the claim" includes tax and penalties, and any paid-in interest that would be refunded. It does not include accrued statutory interest. 28 C.F.R. §§ 0.169 and 0.170.

1. Partnership Level Proceedings.

In cases brought under Code § 6226 for judicial review of Final Partnership Administrative Adjustments, the amount of the Government concession should be calculated by multiplying the adjustment to partnership income by the highest marginal tax rate. For purposes of determining settlement authority, partnership proceedings are considered claims by the United States and not claims against the United States. Consequently, settlements in such cases are not considered "refunds" under Code § 6405 and are not reported to the Congressional Joint Committee on Taxation.

D. Joint Committee on Taxation

Code § 6405 mandates that the Secretary of the Treasury report to the Congressional Joint Committee on Taxation any refunds or credits in excess of $2,000,000 with respect to specified taxes. Since the 1930s there has been agreement among the Department of Justice, the Department of the Treasury and the Joint Committee on Taxation that

the Tax Division will report to the Joint Committee any refunds or credits resulting from settlement in Justice Department cases in accordance with Code § 6405. The Assistant Attorney General must approve all settlements requiring reference to the Joint Committee.

Although Code § 6405 provides only that no refund or credit shall be made until after the expiration of 30 days from the date a report is submitted to the Joint Committee, the Tax Division will not authorize an overpayment until the Joint Committee has advised whether it has any adverse criticism to the settlement.

The refunds or credits that must be reported to the Joint Committee are those relating to:

> income, war profits, excess profits, estate, or gift tax, or any tax imposed with respect to public charities, private foundations, operators' trust funds, pension plans, or real estate investment trusts under chapter 41, 42, 43, or 44 * * *.

Code § 6405(a). Refunds or credits of other excise taxes, employment taxes, and Code § 6672 liabilities need not be submitted to the Joint Committee.

Refunds or credits allowed pursuant to Code § 6411 (tentative allowances) are not referred by the IRS to the Joint Committee at the time of allowance. However, in any such case, to the extent that the tentative allowance as finally adjusted under the settlement exceeds $2,000,000, the refund or credit must be submitted to the Joint Committee. In Tax Division cases, this situation most commonly arises

in corporate bankruptcy cases where the debtor has previously received tentative refunds based on large net operating loss carrybacks. Because settlement of these cases may involve a compromise of the IRS's claim in bankruptcy, those settlements may also require referral to the Joint Committee if there is a refund.

E. Trial Sections

The Assistant Attorney General has redelegated authority to the Chiefs of the Civil Trial Sections and the Court of Federal Claims Section, who are authorized, ***provided that the Internal Revenue Service does not oppose such action,*** to:

(1) Accept offers in compromise in or concede any civil case, in which the amount of the Government's concession, exclusive of statutory interest, does not exceed $500,000;

(2) Accept offers in compromise in injunction or declaratory judgment suits against the United States in which the principal amount of the related liability, if any, does not exceed $500,000;

(3) Accept offers in compromise in all other non-monetary cases; and

(4) Reject offers in compromise in all civil cases, regardless of amount.

Tax Division Directive 139 §§ 1-2.

The Chiefs of the Civil Trial Sections and the Court of Federal Claims are authorized on a case-by-case basis to redelegate to their Assistant Section Chiefs or Reviewers, by memorandum, the authority

delegated to them to reject offers and to accept offers in compromise or approve concessions in which the amount of the Government's concession, exclusive of statutory interest, does not exceed $250,000, provided that redelegation is not made to the attorney of record in the case. Each redelegation memorandum shall be signed by the Section Chief and placed in the Department of Justice case file. Tax Division Directive 139 § 3. A model memorandum for delegation is in Appendix E-1.

F. Appellate Section

The Chief of the Appellate Section is authorized, ***provided that such action is not opposed by the Internal Revenue Service, or by the Chief of the section in which the case originated***, to:

(1) Accept offers in compromise with reference to litigating hazards of the issue(s) on appeal in all civil cases (other than claims for attorneys' fees, litigation expenses, and/or court costs) in which the amount of the Government's concession, exclusive of statutory interest, does not exceed $500,000;

(2) Accept offers in compromise in injunction or declaratory judgment suits against the United States in which the principal amount of the related liability, if any, does not exceed $500,000;

(3) Accept offers in compromise or concede all civil claims for attorney's fees, litigation expenses, and/or court costs in which the aggregate amount of the Government's concession on these claims does not exceed $200,000, and in which the aggregate amount of

the Government's concession in the case, exclusive of statutory interest, does not exceed $500,000;

(4) Accept offers in compromise in all other non-monetary cases that do not involve issues concerning collectability; and,

(5) Reject offers in compromise in all cases, regardless of amount.

Tax Division Directive No. 139 §§ 1, 4. In addition, in certain circumstances, the views of the Solicitor General must be obtained. *See Part II- B, supra.*

The Chief of the Appellate Section is authorized on a case-by-case basis to redelegate to the Appellate Section's Assistant Section Chiefs the authority delegated to the Chief of the Appellate Section to reject offers; to accept offers in compromise and approve concessions with respect to litigation hazards of the issue(s) on appeal in all civil cases (other than claims for attorneys' fees, litigation expenses, or court costs) in which the amount of the Government's concession, exclusive of statutory interest, does not exceed $250,000; and to accept offers in compromise or approve concessions of all civil claims for attorneys' fees, litigation expenses, or court costs, in which the aggregate amount of the Government's concession on these claims does not exceed $100,000, and in which the aggregate amount of the Government's concession in the case, exclusive of statutory interest, does not exceed $250,000, provided that redelegation is not made to the attorney of record in the case. Each redelegation shall be made by memorandum that is signed by the Section Chief and placed in the Department of Justice case file. Tax

Division Directive 139 § 5. A sample memorandum for delegation is in Appendix E-2.

G. Office of Review

The Chief of the Office of Review is authorized, ***provided that such action is not opposed by the Internal Revenue Service, or the Chief of the section*** in which the case originated or is assigned, to:

(1) Accept offers in compromise or concede claims against the United States in all civil cases in which the amount of the Government's concession, exclusive of statutory interest, does not exceed $1,500,000;

the United States in all civil cases in which the difference between the gross amount of the original claim and the proposed settlement does not exceed $1,500,000 or 15% of the original claim, whichever is greater;

(3) Accept offers in compromise in all non-monetary cases; and

(4) Reject offers in compromise or disapprove proposed concessions in all cases, regardless of amount.

Tax Division Directive No. 139 § 6.

The Chief, Office of Review, may redelegate on a case-by-case basis to the Office's Assistant Chief or Reviewer, the authority delegated to the Chief, Office of Review, to reject offers, and the authority to accept offers in compromise in or concede all civil cases in which the Government's concession, exclusive of statutory interest, does not exceed $750,000, provided that redelegation is not made to the

attorney-of-record in the case. Each redelegation shall be made by memorandum that is signed by the Chief and placed in the Department of Justice file for the case. Tax Division Directive No. 139 § 7.

H. Deputy Assistant Attorneys General

Deputy Assistant Attorneys General are authorized, ***provided that such action is not opposed by the Internal Revenue Service***, to:

(1) Accept offers in compromise of or concede claims against the United States in all civil cases in which the amount of the Government's concession, exclusive of statutory interest, does not exceed $2,000,000;

(2) Accept offers in compromise of or concede claims on behalf of the United States in all civil cases in which the difference between the gross amount of the original claim and the proposed settlement does not exceed $2,000,000 or 15% of the original claim, whichever is greater;

(3) Accept offers in compromise in all nonmonetary cases; and

(4) Reject offers in compromise or disapprove proposed concessions in all cases, regardless of amount.

Tax Division Directive No. 139 § 8.

The Principal Deputy Assistant Attorney General, in addition to the foregoing, is authorized, ***provided that such action is not***

opposed by the Internal Revenue Service, to:

> (1) Accept offers in compromise and settle administratively claims against the United States in all civil cases, regardless of amount in all cases in which the Joint Committee on Taxation has indicated that it has no adverse criticism of the proposed settlement, provided that such action is not opposed by the agency or agencies involved.
>
> (B) Consistent with, and subject to the limitations of, 28 CFR § 0.168, and in the absence of an Assistant Attorney General, redelegate authority under this Directive to subordinate division officials and United States Attorneys.

Tax Division Directive No. 139 § 9.

I. United States Attorneys

While the United States Attorney offices in the Southern District of New York and the Central and Northern Districts of California have trial responsibility for tax litigation to the same extent as a regional Trial Section, they do not have independent settlement authority. That authority resides in the regional Trial Section charged with supervising the tax litigation in those offices.

When the Tax Division has formally referred a judgment to the United States Attorney for collection, and ***provided the Internal Revenue Service concurs in writing with the proposed action,***

United States Attorneys are authorized to:

(1) Reject offers in compromise of judgments in favor of the United States, regardless of amount;

(2) Accept offers in compromise of judgments in favor of the United States where the amount of the judgment does not exceed $300,000; and

(3) Terminate collection activity by that office as to judgments in favor of the United States which do not exceed $300,000, if the United States Attorney concludes that the judgment is uncollectible.

Tax Division Directive No. 139 § 10.

Additionally, pursuant to Tax Division Directive No. 83, United States Attorneys may release the right of redemption of the United States in respect of tax liens, arising under 28 U.S.C. § 2410(c) or under state law, when the United States has been joined as a party to a suit, provided that:

(1) The action only relates to real property on which is located one single-family residence, or to any other real property having a fair market value not exceeding $200,000, except that the limitation as to value or use shall not apply in those cases in which a federal agency requests the release,

(2) The consideration paid for the release must be equal to the value of the right of redemption, or $50, whichever is greater, except that no consideration shall be required for releases issued to any federal agency, and

(3) The United States Attorney has obtained appraisals by two disinterested and well-qualified persons, except that in those cases in which the applicant is a federal agency, the agency's appraisal may be substituted for the two appraisals generally required.

J. Conditions and Limitations on Settlement Authority

Settlement authority is subject to certain conditions and limitations. Tax Division Directive No. 139 § 11.

(1) Other claims affected. When, as a practical matter, the compromise or concession of a particular claim will control or adversely influence the disposition of other claims totaling more than the respective amounts designated, the case shall be forwarded for review at the appropriate level for the cumulative amount of the affected claims. Tax Division Directive No. 139 §11(A).

(2) Issue warrants higher-level review. Those to whom settlement authority has been delegated are free to seek higher level of review when they think it appropriate. Tax Division Directive No. 139 § 11(B). Those decisions often rest on the importance of a question of law or policy presented, the position taken by the IRS or by the United States Attorney involved, or the possible impact on other cases.

(3) Case previously submitted to Joint Committee. When the Tax Division has previously submitted a case to the Joint Committee on Taxation, leaving one or more issues unresolved, any subsequent compromise or concession in that case must be

submitted to the Joint Committee, whether or not the subsequent overpayment exceeds the amount specified in Code § 6405. Tax Division Directive No. 139 § 11(C).

K. Determination of Settlement Jurisdiction Amounts

Except for the conditions and limitations just discussed, in general, settlement authority depends on the amount that the Government concedes, whether by compromise or concession.

1. Gross Amount of the Claim.

The gross amount of the claim includes tax, penalties and paid-in interest. It does not include accrued statutory overpayment interest in a refund suit or accrued statutory underpayment interest owed by the taxpayer. 28 C.F.R. § 0.170. Concession of any part of the gross amount of the claim against or on behalf of the Government is taken into account in determining jurisdictional limits.

(a) Unpaid interest (assessed or unassessed) under § 6601. Unpaid interest on a claim by the Government imposed by Code § 6601, assessed or unassessed, is not taken into account in determining the gross amount of the claim, and thus is not taken into account in determining settlement authority.

(b) Interest paid under § 6601. In refund suits, interest paid by a taxpayer under Code § 6601 which will constitute an overpayment under the settlement is taken into account in determining settlement authority.

(c) Statutory interest on an overpayment under § 6611. Statutory interest to be paid on the amount of the overpayment pursuant to Code § 6611 is not taken into account in determining settlement authority, unless the case relates solely to interest.

(d) Refund suits with counterclaims. Where both overpayments and counterclaims (or deficiencies) are involved, add together the amount being conceded on the claims by and against the Government to determine the jurisdictional amount. For example, assume a $500,000 refund claim that is being settled by the concession of a $50,000 overpayment (exclusive of overpayment interest) and the concession of a $300,000 counterclaim. The jurisdictional amount of the Government concession is $350,000.

2. Settlement relates solely to statutory interest.

Where a settlement or concession of a claim against the Government relates solely to interest under Code § 6611, the amount of any increase in statutory interest previously determined by the IRS, whether being agreed to or conceded by the United States, is the jurisdictional amount which determines authority to act on the settlement or concession.

3. Specific property, including interplead funds.

When settlement relates only to a specific property or fund, such as is the case with an interpleader, and the total amount of the fund (or value of the property) is less than the Government's claim, then the

amount of the fund (or value of the property) conceded determines jurisdictional limits.

4. Cases commenced under Code § 6226.

For purposes of determining the person with whom settlement authority lies, claims in cases commenced under Code § 6226 are considered claims by or on behalf of the United States, rather than claims against the United States. Although petitioners in cases commenced under Code § 6226 must make a jurisdictional deposit, we view these cases as claim by or on behalf of the United States. In the event the petitioner prevails, it is entitled to a return of the jurisdictional deposit, plus statutory interest. Likewise, if the case is resolved by settlement, the settlement may provide for a return of the deposit, plus statutory interest. A return of a deposit, however, is not a refund of an overpayment.

Consequently, compromises in cases commenced under Code § 6226 will not be referred to the Congressional Joint Committee on Taxation even when the amount of the deposit returned exceeds $2,000,000. Instead, a concession in a Code § 6226 case that exceeds $2,000,000 must be approved by the Associate Attorney General. The amount of the claim to be conceded is the total amount of the adjustments set forth in the Notice of Final Partnership Administrative Adjustment, multiplied by the highest potential tax rate of the partners whose tax liability was, but for the adjustments in the Notice of Final

Partnership Administrative Adjustment, reduced. *See* AAG Memorandum of June 29, 2007.

L. Stipulations of Fact

Trial Attorneys often question whether factual stipulations must be processed as concessions.[1] Although the line between concession and factual admission can be a fine one, generally, a factual stipulation does not constitute a concession unless it is an admission of an ultimate fact that would entitle the taxpayer to a judgment or partial judgment – *e.g.*, a stipulation as to the value of property in a valuation case. A factual stipulation may also rise to the level of a concession if the number and kind of facts stipulated result in the opposing party being entitled to judgment or partial judgment on the issue(s) to which the stipulation pertains. For example, in a Code § 6672 case, stipulating that a taxpayer was a salesman for the delinquent corporation, or did not have check-signing authority, would normally not be considered a concession. Compare that to a substantiation of expenses case where the taxpayer produces some, but not all, of the records establishing the expenses claimed as deductions. In that situation, the Trial Attorney's stipulation that the taxpayer has substantiated specified expenses would entitle the taxpayer to a partial refund, or a reduction in the Government's claim, and would therefore be considered a concession. If you have any doubt about whether a stipulation of one or more facts would constitute a concession, discuss the matter with a supervisor.

[1] Of course, all stipulations should be approved by a supervisor, regardless of whether they constitute a concession.

M. Waiving a Legal Argument

Waiving a legal argument, or stipulating that a legal argument is not valid, is generally not considered a concession.[2] For example, assume a Trial Attorney is defending a refund suit based on the insufficiency of the refund claim – a defense that, if successful, would result in a complete victory for the Government. Assume further that the IRS has not challenged the underlying merits of the claim and the Trial Attorney's investigation shows that the taxpayer would otherwise be entitled to the refund sought, absent the insufficient claim. Waiving the legal argument that the claim was insufficient, while not constituting a concession, should be discussed with and approved by the Trial Attorney's supervisor. Similarly, the decision to oppose attorney's fees on the basis that the Government's position was substantially justified, but not to challenge the amount of the fees, believing the amount of fees claimed is reasonable, is not a concession, but should be discussed with and approved by a supervisor. Finally, if you have any doubt about whether a waiver constitutes a concession, discuss the matter with your supervisor in the context of the entire case.

N. Partial Settlements

There are times when partial settlements are either advisable or necessary. In such cases, a partial settlement both narrows the issues for trial and permits the Government to present its case most forcefully

[2] Again, such a waiver or stipulation must be approved by the Trial Attorney's supervisor, who may elect to have the matter considered at higher levels, including the appropriate Deputy Assistant Attorney General.

on appeal. Partial settlements may not be in the Government's best interest in every case, however, because relationships between the issues settled and those reserved for litigation may not become apparent until (too late) when the latter are addressed. Moreover, settlement of the case as a whole obviates multiple computations, the preparation of more than one compromise memorandum, and the review of more than one memorandum by the designated official.

Additionally, whether to schedule an overpayment immediately on conclusion of a partial settlement will depend on a number of factors, including the posture of the case, the complexity of the necessary computations, and any possible interrelationship with issues which remain to be litigated. If an overpayment is to be allowed by a partial settlement, it is advisable to obtain the taxpayer's agreement, as part of the partial settlement, that it will repay any portion of the overpayment resulting from the partial settlement that may subsequently be determined to be due upon final resolution of the case.

O. Classification as Standard or SOP

At the commencement of litigation, the Chief Counsel classifies tax cases as Standard or under the IRS's settlement option procedure (SOP). SOP cases generally involve factual issues or nonrecurring legal issues.

The Tax Division does not need Chief Counsel's recommendation in SOP cases that are compromised, even if the case requires reference

to the Joint Committee on Taxation. However, in SOP cases where full concession of an issue or a case is proposed, the Trial Attorney must obtain a recommendation from Chief Counsel (except in cases involving liability under Code § 6672).

The classification as Standard or SOP should appear in the letter from Chief Counsel authorizing suit or providing for a defense of the case. If the letter from Chief Counsel in general litigation cases fails to classify the case, the Tax Division may assume that the case is classified SOP. It is good practice, however, to contact IRS counsel to confirm the SOP designation if you think the omission of a designation was an oversight. If the letter from Chief Counsel in a refund suit fails to classify the case, the Tax Division cannot assume the case is classified SOP. The Trial Attorney should contact Chief Counsel and request that the case be classified. After development of a case, the Trial Attorney may find that the case does not warrant a Standard classification; in that event the Trial Attorney should discuss with a supervisor whether to ask Chief Counsel to reclassify the case as SOP.

P. IRS Authority to Settle Cases in Litigation

1. General Rule

Once a tax matter has been referred to the Department of Justice for prosecution or defense, the Department of Justice has exclusive settlement authority. *See* October 2, 1934, Opinion of the Attorney General; 38 U.S. Op. Atty. Gen. 98 (App. D-1); Exec. Order No. 6166,

§ 5, June 10, 1933 (reprinted in 5 U.S.C.A. § 901); Code § 7122(a). The tax liability for each year or other period constitutes a separate cause of action. *Commissioner v. Sunnen*, 333 U.S. 591, 598 (1948). Accordingly, the IRS cannot compromise or concede a tax liability (in whole or in part) that has been referred to the Department of Justice to commence a suit, or is the subject of litigation in a court other than the Tax Court.

After the Tax Division obtains a judgment on a Government claim – *e.g.*, a counterclaim in a refund suit, or a suit to reduce an assessment to judgment – the Department retains all settlement authority. The assistance and efforts of the IRS are, of course, essential in obtaining information about collection potential and in collection itself. Nonetheless, without the knowledge and consent of the Tax Division, the IRS should not compromise a liability that is included in a judgment unless the Tax Division approves the compromise.

2. Bankruptcy Cases

In bankruptcy cases, the IRS has jurisdiction to settle, compromise or reduce a proof of claim under certain limited circumstances. *See* Internal Revenue Manual (RIA) 34.3.1.1.7; 2007 WL 3154872.

(a) Before or after objection to a proof of claim

The IRS may reduce proofs of claim based on criteria ordinarily used by revenue agents or revenue officers in resolving cases (for

example, a concession where it is clear that the tax is not due, or one based on acceptance of substantiation), but may not consider hazards of litigation, whether or not an objection has been filed. After an objection has been filed, however, the IRS may negotiate a settlement based on non-litigation hazard criteria ordinarily used by revenue agents or revenue officers in resolving cases only if the debtor or trustee agrees to an extension so that the objection will not be heard earlier than 30 days after the termination of negotiations.

(b) Before objection to a proof of claim

The IRS has jurisdiction to settle a claim based on litigating hazards after the petition in bankruptcy is filed as long as no objection has been filed and the IRS reduces the settlement to a closing agreement that binds both the debtor and the trustee. (In a no-asset case, the agreement of the trustee is not necessary.)

(c) After objection to a proof of claim

After an objection to a proof of claim is filed, the IRS may not settle a claim if litigation hazards, including choosing the proper litigation vehicle and forum, are any part of the consideration for settlement. Once an objection is filed, such settlement authority resides with the Tax Division.

III. THE SETTLEMENT PROCESS

A. Settlement Discussions

1. Preparation and Negotiation

Negotiation is a part of the everyday life of a Trial Attorney. Effective negotiation is a skill, just like effective cross-examination, and when done well, is a useful tool to reach a just resolution. Effective negotiation also requires preparation – leave yourself time to think about and prepare for settlement discussions, just as you prepare for a hearing. Negotiation is not confined to formal settlement discussions, but cuts across all aspects of litigation, from scheduling discovery to preparing a joint pre-trial order.

On a consistent basis, think about the possibility and desirability of negotiating a settlement, the possible terms of settlement, and whether to use any form of alternative dispute resolution (ADR). Of course, as the case is developed factually and legally, your assessment of a feasible or appropriate settlement will change.

It is a good idea for a Trial Attorney to discuss settlement potential and obstacles to settlement with the Section Chief or an Assistant Chief before engaging in settlement negotiations. Bear in mind, however, that these discussions may not cover all aspects of the facts and law, and a Chief may later raise questions or objections that

the Chief did not recognize until reviewing the Trial Attorney's memorandum.

Taxpayers and other litigants, as well as the court, may request or require a commitment to process the settlement within a time certain. Of course, the Trial Attorney should write up a negotiated settlement promptly, but must be careful not to make overly optimistic promises. Before making any commitments, no matter how tentative, regarding the time it may take to process a settlement, the Trial Attorney should check with the Chief Counsel and the Section Chief. In a case which requires reference to the Office of Review, the Trial Attorney also should check with the Chief of the Office of Review. Frequently, issues arise during review that were not apparent to the Trial Attorney, and resolution of those issues may take additional time.

2. Formal Settlement Discussions

Many courts set early settlement conferences, sometimes in conjunction with case management conferences. *See* F.R.C.P. 16. Early settlement discussions comport with the policies of the Tax Division and Executive Order 12988 on Civil Justice Reform. The Trial Attorney does not need to wait for a court order setting a formal conference to begin settlement discussions. The Trial Attorney should be ready for meaningful settlement discussions as soon as adequate information is available to permit an accurate evaluation of the litigation hazards and/or collectability concerns. Conversely, if the Trial Attorney does not have the necessary information to evaluate the case, settlement

discussions will be premature and likely unproductive, causing, rather than reducing, inefficient case management.

3. Settlement Conferences with the Court

Generally, an order requiring a settlement conference will direct the Trial Attorney of record to attend. The Tax Division expects its Trial Attorneys to be in a position to participate in meaningful settlement negotiations and affords significant weight to Trial Attorney settlement recommendations. Before attending the conference, the Trial Attorney should discuss settlement prospects with the Section Chief, evaluate the information available, and develop guidelines for analyzing a settlement proposal (which may include the need to develop additional factual information). By the time of a conference, if not earlier, the Trial Attorney should be able to espouse the strengths of the Government's position, as well understand any weaknesses, and then approach settlement discussions with an open and reasonable view. Before the settlement conference, the Trial Attorney should determine who has settlement authority in a particular case. See *Part II*, above for a further discussion of settlement authority.

Court orders (and local rules) vary concerning settlement conferences. When first receiving notice of a conference, the Trial Attorney must ascertain who is required to attend. Depending on the amount in suit and the case's designation as Standard or SOP, a court order requiring the attendance of a person with "full settlement authority" could be requiring the Section Chief, the Assistant Attorney

General, or even the Associate Attorney General to attend. In some cases, because the level of settlement authority differs based on whether the IRS agrees with the recommendation or not, it may not be possible to say with certainty who has settlement authority, even in a low-dollar case, where the taxpayer has not proposed terms before the conference.

Upon receiving an order requiring the attendance of the person with full settlement authority, the Trial Attorney should immediately consult with the Section Chief. In addition, the Trial Attorney should consult the local rules of the court, as some courts have created special rules for cases handled by the Government, which may not be apparent from a standard scheduling order. The Trial Attorney should also ask a local Assistant United States Attorney and/or fellow Trial Attorneys who practice in that jurisdiction whether the Department has been excused from similar orders in other cases, and how best to request relief from the requirement. In some courts, it is only necessary to contact the court's clerk (with knowledge of opposing counsel) and attempt to find an informal way to be excused from the requirement. In other situations, the Section Chief may believe it will be helpful for the Chief or some other supervisor to be available by phone during the conference and this alternative may be proposed to the court. A Trial Attorney should not offer to have a Chief, including the Chief of the Office of Review, available by telephone without first consulting the affected Chief.

If informal efforts fail, under most circumstances, the Section Chief would authorize the filing of a motion with the trial court asking to be excused from the local rule or court order and, in the alternative, seeking a stay of the conference pending consideration by the Tax Division and the Solicitor General of whether to petition for mandamus. If the motion is denied, the Tax Division may seek an emergency stay from the court of appeals and petition for writ of mandamus excusing the person with full settlement authority from appearing.

Officials with the Department of Justice and the Tax Division would not be able to attend to all of their responsibilities if high level officials must attend settlement conferences around the country in cases assigned to Trial Attorneys for handling. Most courts recognize that it is inappropriate to require the Associate Attorney General to attend settlement conferences. It may be necessary to educate the court about the scope of the responsibilities of the Assistant Attorney General for the Tax Division, noting it would be physically impossible for the Assistant Attorney General to attend settlement conferences on a regular basis, or even to participate by phone in the thousands of cases pending in the Division. Indeed, requiring a Section Chief to attend in person all settlement conferences in districts within the Section could consume all or the greater portion of the Chief's time and make it impossible for the Chief to perform the many other functions of the position. It is unfair to other taxpayers whose cases do not receive attention if a Chief must devote undue time and attention to one case because a judge has ordered the Chief to attend a settlement conference.

The Department has sound legal arguments that a court lacks the inherent power to issue an order requiring the attendance at a settlement conference of the person with full settlement authority. Under the doctrine of separation of powers as expressed in 28 U.S.C. §§ 517 and 519, the Attorney General has the responsibility of representing the United States in judicial proceedings and directing other offices of the Department in conducting litigation. A court lacks the power to tell the Attorney General what settlement authority must be conferred on the Trial Attorney designated to handle a particular case, or to decide who will represent the United States in a particular proceeding.

The problems inherent in requiring Government officials with full settlement authority to attend settlement conferences were recognized in Section 473(c) of the Judicial Improvements Act of 1990, Pub. L. No. 101-650, 104 Stat. 5089, 5093 (1990):

> Nothing in a civil justice expense and delay reduction plan relating to the settlement authority provisions of this section shall alter or conflict with the authority of the Attorney General to conduct litigation on behalf of the United States, or any delegation of the Attorney General.

The legislative history of the Judicial Improvements Act, likewise, reveals that Congress was aware of, and believed district courts should account for:

> [T]he unique situation of the Department of Justice. The Department does not delegate broad

> authority to all trial counsel, but instead reserves that authority to senior officials in the United States Attorneys' Offices or in the litigating divisions in Washington. Clearly the Department cannot realistically send officials with full settlement authority to each settlement conference.

H.R. Rep. No. 101-732, 101st Cong., 2d Sess. 16-17; S. Rep. No, 101-426, 101st Cong. 2d Sess. 59 (emphasis added). *See also, In re Stone*, 986 F.2d 898 (5th Cir. 1993). The Advisory Committee Notes on the amendment to Rule 16 of the Federal Rules of Civil Procedure, effective December 1, 1993, specifically provide that:

> Particularly in litigation in which governmental agencies or large amounts of money are involved, there may be no one with on-the-spot settlement authority, and the most that should be expected is access to a person who would have a major role in submitting a recommendation to the body or board with ultimate decision-making responsibility. The selection of the appropriate representative should ordinarily be left to the party and its counsel.

The issue of a court's power to compel attendance of a Justice Department official with full settlement authority has, to date, been sparsely addressed by the appellate courts. The Fifth and Ninth Circuits both held that the district court has the inherent power to order the Executive Branch to send a high-ranking official to a settlement conference, but it vacated the district court's orders and stated that the district court had abused its discretion in routinely ordering the Government to send an official with full settlement authority to a conference. *In re Stone*, 986 F.2d 898 (5th Cir. 1993);

United States v. U.S. District Court for the Northern Mariana Islands, __ F.3d __, 2012 WL 3984406 (9th Cir. September 12, 2012). The courts went on to state, however, that the court could issue such an order in certain extraordinary circumstances. *Id.; see also*, *In re U.S.,* 139 F.3d 332 (5th Cir. 1998).

4. Alternative Dispute Resolution

The vast majority of cases handled by the Division are settled or resolved by dispositive motion. Most settlements are negotiated attorney-to-attorney, without the intervention of a third-party such as a Magistrate Judge or mediator. Where traditional negotiation is not effective, however, Alternative Dispute Resolution (ADR) may be useful.

All federal courts encourage ADR use. Many require parties to report on the potential efficacy of ADR in a case, often as early as the Rule 16 conference. We have been directed, by executive order, to use ADR, where appropriate:

> Litigation counsel shall make reasonable attempts to resolve a dispute expeditiously and properly before proceeding to trial . . . where the benefits of Alternative Dispute Resolution ("ADR") may be derived, and after consultation with the agency referring the matter, litigation counsel should suggest the use of an appropriate ADR technique to the parties.

Executive Order No. 12,988, 61 Fed. Reg. 4729 (1996).

Many of the factors favoring and disfavoring ADR are the same factors favoring or disfavoring traditional settlement negotiations. If a case can be resolved in the Government's favor on summary judgment, it is not a good candidate for settlement, no matter how the negotiations are conducted. Cases that turn on specific factual determinations, where both parties have significant risks, are good candidates for settlement. If traditional attorney-to-attorney negotiation is not productive, ADR may work.

(a) Mediation

Mediation, the most common form of ADR, is negotiation facilitated by a third-party neutral. In mediation, Trial Attorneys use the advocacy and negotiation skills they would use to reach any settlement. The mediator may help the Trial Attorney find a path to settlement. In mediation, the parties usually meet with the mediator together, and then separately. The mediator may facilitate face-to-face negotiations or communicate offers back and forth. Such "shuttle" mediation can help overcome irrational or emotional responses to an offer, because the solution is not obviously attributable to either party. In some cases, mediation is preferable to a settlement conference with a Magistrate Judge, because at a conference with a Magistrate Judge, the lawyers do not set the ground rules and cannot easily walk away.

Sometimes, mediation is court-ordered. Court-mandated or court-sponsored ADR should be viewed as a judicial proceeding; disclosures of returns and return information in judicial proceedings are subject to

Code § 6103(h)(4) and may be made in accordance with that provision. Other times, mediation is consensual. When mediation is by agreement, rather than court order, the rules and procedures for the particular mediation are established by a mediation agreement between the parties and the mediator. In the event of non-court ordered mediation, obtain a waiver of Code § 6103 disclosure restrictions from the taxpayer(s) so that there is no question about our ability to share information with the mediator. *See* Code § 6103(c). The taxpayer, all parties, and any other person or entity (*e.g.,* an ex-spouse, not party to the proceeding) whose returns or return information may be disclosed during the mediation should execute written waivers which contain the information required by Form 8821.

The mediator must be retained and arrangements made for payment for services; also the mediator should execute a confidentiality agreement. Follow the procedures for expert witnesses contained in http://taxnet/LitigationSupport/ExpertWitnesses/ExpertWitnesses.aspx.

Mediation does not increase a Trial Attorney's settlement authority. Nor does it affect the Division's practice that people with settlement authority do not generally participate in negotiations. It is important for all parties to understand this before agreeing to mediate. Experience has shown that this is not an impediment to effective mediation. At times it is worthwhile to bring someone from the IRS, who although lacking settlement authority, gives the taxpayer an additional opportunity to be heard. Unlike attorney-to-attorney negotiation, you can speak directly to the other side in mediation if the

clients are present. This can be a particularly useful feature of mediation if you suspect that the taxpayer and his counsel's interests diverge in any way. In such cases, a taxpayer's presence at the table may improve the chances of settling the case. Mediation often exposes and diffuses unrealistic assessments of litigation hazards. It can be very useful for all the parties and their counsel to hear an independent assessment of litigation hazards directly from the neutral mediator.

In some cases, taxpayers are motivated by considerations other than money, such as a sense of having been treated unfairly by the IRS. You are more likely to learn of this in mediation than in traditional negotiation. The flexibility of the mediation process may help the parties develop creative ways to satisfy the taxpayer's underlying needs.

1. Choosing a Mediator

Selecting a mediator is a strategic decision. Consider what kind of help you think you need in overcoming impasses to settlement and choose accordingly. Interview mediators you consider. Mediators differ in style and skill. Some mediators are better at facilitating discussion between the parties. Others are more evaluative, and see their role as providing a reality check. An evaluative mediator can be very useful if one of the parties is particularly unrealistic. On the other hand, where the parties are sophisticated, an evaluative mediator may engender resentment. The credibility of the mediator depends on his or her skill, knowledge and experience. Knowledge of substantive law and experience with tax cases is likely to be more important in choosing an

evaluative mediator in Tax Division cases. Former judges often use an evaluative mediation style.

2. Paying for a Mediator

The Department is so committed to ADR that it maintains a fund to pay for mediators, which is administered by the Office of Dispute Resolution. Additional information can be found on the website of the Office of Dispute Resolution. Also, the Interagency Alternative Dispute Resolution Working Group maintains a web site at http://www.adr.gov/index.html. The procurement aspects of hiring a mediator are covered on the Tax Division intranet, under at http://taxnet/LitigationSupport/ExpertWitnesses/ExpertWitnesses.aspx

(b) Other Forms of ADR

Although mediation is the most common form of ADR, other ADR formats exist. The next most common ADR process is Early Neutral Evaluation ("ENE"). ENE is generally employed at a very early stage of litigation. Because our cases are often not fully developed when we receive them, ENE is unlikely to be helpful, although many courts require it.

Arbitration, which is essentially a trial before a private judge, is another form of ADR. Although permissible, arbitration is rarely, if ever, used in Tax Division cases. If the case is important enough to be tried, it is probably important enough to be tried in federal court.

Parties to binding arbitration give up their right to appeal, which may not be in the Government's interest. Because arbitration can be disadvantageous, there are many limitations on the Government's participation. The agreement to arbitrate must be approved by the person with settlement authority and a binding recovery ceiling must be approved in advance. If a party seeks arbitration, the Trial Attorney should immediately bring the matter to a supervisor's attention.

B. Offers

The taxpayer's offer and the Government's acceptance form a contract. The parties' failure to state their intentions clearly can lead to misunderstandings that in the worst-case scenario may result in a contract dispute that requires judicial resolution or may result in a court finding that there was no agreement. Accordingly, the terms of the agreement should be memorialized in a written document.

1. Offer and acknowledgment

It is usually in the best interests of both parties for the taxpayer to make a written offer that covers all issues that should be resolved by the settlement – even if the taxpayer makes an oral offer at a pretrial conference with a judge in attendance. The offer should contain all the proposed terms of settlement. This avoids disputes as to what the parties intended and the admission of parol evidence. A well-crafted offer letter can save all parties unnecessary work or additional litigation. In some cases, it may be appropriate for the Trial Attorney

to draft a letter summarizing the terms of the offer being made as the Trial Attorney understands them. The taxpayer can then adopt the letter as its offer. The Trial Attorney should be clear that such a letter does not represent an offer by the Government and that the offer is not accepted until the appropriate delegate of the Attorney General accepts the offer.

The offer should address all issues that could arise as a result of the settlement, including items such as crediting any overpayment in accord with Code § 6402, attorney fees, terms of payment and effect of default (when the offer calls for payments by the taxpayer or a third party), and interest on either the refund to or payment by the taxpayer. In short, an offer should cover all collateral issues. For a further discussion of some of the more frequently occurring collateral issues, see *Part V below*.

The Trial Attorney should send an acknowledgment letter promptly, generally within three days of receiving the offer. This letter should clarify any term of the offer that needs revision. If the offer does not require clarification, an acknowledgment is still helpful, but no restatement of the terms is necessary. If the acknowledgment letter is, in effect, stating new terms (even though they are relatively modest provisions), require the taxpayer's written agreement to the revisions, preferably by requesting the taxpayer or the taxpayer's representative sign and return a copy of the acknowledgment letter. See Appendix F for an example. If the acknowledgment letter asks the taxpayer to

signify agreement to revisions, then take steps to ensure an executed document is received before action is taken on the offer.

When a taxpayer initially drafts an offer, the Trial Attorney is often required to spend time clarifying (after the fact) what a settlement offer really means. It may be helpful to ask opposing counsel for a draft offer for discussion, suggest revisions, and then have taxpayer make the actual offer. In some cases, after discussion with the taxpayer or opposing counsel, it may be helpful if the Trial Attorney drafts a letter that reflects his or her understanding of the offer made by the taxpayer (being careful, of course, not to make an offer).

If the offer letter contains terms that are totally unacceptable but the offer is otherwise worthy of consideration, the Trial Attorney should consider restating the terms that the Trial Attorney would recommend, pointing out the unacceptable terms, and asking the taxpayer's representative to confirm in writing whether they want to make a revised offer containing only the recommended terms.

2. Counteroffers

Inasmuch as the Trial Attorney does not have settlement authority, the attorney must take care not to make a counteroffer, rather than stating what the attorney is willing to recommend. In an unusual case, after a settlement memorandum has been prepared, it may be appropriate for the Trial Attorney, while recommending rejection of a pending offer, to recommend making a formal

counteroffer. Counteroffers require agreement by Chief Counsel to the settlement proposed in all cases classified Standard. In all cases a counteroffer must be formally approved by the person who would have authority to accept the offer before it can be communicated to the other side.

3. Qualified offers

The qualified offer provisions are found in Code § 7430. Congress' stated purpose for enacting this provision was to "provide an incentive for the IRS to settle taxpayers' cases for appropriate amounts." Because a qualified offer is in effect a fee-shifting device, it is important to identify a qualified offer when made and follow appropriate procedures to determine whether the offer meets the statutory requirements Code § 7430(g).

A qualified offer is a written offer that (a) is made by the taxpayer to the United States during a "qualified offer period," (b) specifies the amount of the taxpayer's liability (determined without regard to interest), (c) is designated as a "qualified offer" at the time it is made, and (d) remains open until the earliest of the date the offer is rejected, the date the trial begins, or the 90th day after the date the offer is made. Code § 7430(g)(1).

A qualified offer may be made only during the qualified offer period, which begins on the date the IRS sends the taxpayer a first letter of proposed deficiency (which allows the taxpayer an opportunity

for administrative review by IRS Appeals), and ends 30 days before the first trial setting. The qualified offer period may not be extended, but a qualified offer may remain open beyond the end of the qualified offer period.

Under Code § 7430, a "prevailing party" may, if stated conditions are met, recover the reasonable administrative and litigation costs (including attorneys fees paid or incurred) if the court proceedings relate to the determination or refund of any tax, interest, or penalty. Code § 7430(g) significantly expands the definition of "prevailing party" to include a taxpayer who has made a qualified offer, if the taxpayer's liability under the last qualified offer equals or exceeds the amount of the taxpayer's liability under the judgment entered by the court. Thus, a taxpayer may be deemed a prevailing party even though the taxpayer did not substantially prevail on the amount in controversy or the most significant issue. *See* Code § 7430(c)(4)(E). Moreover, the question whether the position of the United States in the administrative and litigation proceedings was substantially justified is not relevant to the award of attorneys' fees. For these reasons, it is imperative that qualified offers be scrutinized carefully.

In addition:

(a) To qualify as a prevailing party, taxpayers must meet the net worth requirements of Code § 7430(c)(4)(A)(ii). Taxpayers must also meet other requirements of Code § 7430, such as not unreasonably protracting the proceedings and, for purposes of an

award of litigation costs, exhausting their administrative remedies.

(b) A taxpayer cannot qualify as a prevailing party if the determination of the court with respect to the adjustments included in the qualified offer is entered exclusively pursuant to a settlement.

(c) A taxpayer cannot qualify as a prevailing party in any proceeding in which the amount of the tax liability is not at issue. For example, a taxpayer cannot utilize a qualified offer in a declaratory judgment proceeding, or a proceeding to enforce or quash a summons.

(d) Reasonable administrative and litigation costs include only costs incurred on and after the date a qualified offer is made.

Code § 7430 is silent regarding how the liability under the judgment is determined. It seems reasonably clear from the statute and legislative history that only the liability at issue in the case is included in the qualified offer, and that the total amount of liability under the offer at the time the offer is made must be compared to the outcome at the end of the case. Because tax cases may involve multiple issues, questions may arise as to how the ultimate outcome of the case (as embodied in a money judgment) may be affected, if at all, by the outcome on a particular issue. Questions may also arise when some, but not all, issues presented by a case are settled before a decision on the remaining issues is entered and a money judgment is rendered. Most, if not all cases that are susceptible to a qualified offer will end in money judgments for discrete taxable periods.

C. Concessions and administrative settlement

As litigators for the United States, one of the Tax Division's important functions is to ensure that the Government has a legitimate litigation position in each case that we handle. It is our obligation to concede cases, or issues within a case, which lack merit. A Trial Attorney who believes that the Government should concede an issue or the entire case must obtain the recommendation of the Chief Counsel, even in cases designated SOP. (The one exception to this rule is that we need not request the views of the Service in a trust fund recovery penalty case under Code § 6672 classified SOP.)

Generally, it is undesirable to process a proposed concession as to only part of a case if the entire case can be resolved by settlement and, therefore, a proposed partial concession usually will not be processed until the Trial Attorney has explored the possibility of settling the entire case. When an overall settlement is not achieved, the Trial Attorney's memorandum recommending the partial concession should explain why the entire case could not be resolved.

Whether and how we should negotiate over attorney fees with a taxpayer's representative when concession is being considered, is a delicate area requiring careful analysis. Whenever possible, cases that are conceded by the Government should be terminated by a stipulation for dismissal with prejudice, each party to bear its own fees and expenses including attorney fees. In some cases, concession is

warranted because, while the United States has a defensible position, the litigating hazards do not justify the litigating expenses, or the case or issues being conceded do not present a good litigating vehicle. In these situations, concession would ordinarily not be warranted if attorney fees are not waived, since the matter would essentially have to be litigated to resolve the fee dispute. Where the person with final authority determines that full or partial concession will be conditioned upon settlement or waiver of costs and attorney fees, opposing counsel should be informed that any concession is conditioned on disposition of the issue of costs and attorney fees. Where full or partial concession is warranted whether or not the issue of costs and attorney fees is resolved, opposing counsel should be informed of the decision to concede before the issue of costs and attorney fees is broached, and there should be no suggestion that concession is dependent upon resolving the issue of costs and attorney fees. *See* Appendix R for an example. When cases or issues are conceded without resolution of a potential claim for attorney fees, a judgment will be entered, leaving the award issue open. In those cases, the Trial Attorney should promptly request that Chief Counsel provide an analysis of the facts and law on the fee and cost issues left open, unless such an analysis has previously been received.

D. Summary rejection

A Trial Attorney who determines, in consultation with the Section Chief or Assistant Chief, that a taxpayer's offer does not merit serious consideration, should promptly prepare a brief memorandum

recommending summary rejection, and should not request the recommendation of IRS Counsel.

E. Soliciting the Chief Counsel recommendation

If an offer merits consideration, or if the attorney is considering recommending concession, the attorney should determine whether the Chief Counsel has classified the case as Standard or SOP (Settlement Option Procedure), and as appropriate to the classification, obtain the views of Chief Counsel.

1. Standard cases

In cases classified Standard by Chief Counsel, the Trial Attorney shall request promptly (*i.e.*, within 3 days of receipt of the offer) the recommendation of Chief Counsel. The Trial Attorney also may forward a copy of a draft compromise memorandum, or other documents such as deposition transcripts, to Chief Counsel to assist in their evaluation of the proposal. Participation in ADR does not obviate the need to obtain the views of Chief Counsel in Standard cases.

2. SOP cases

In cases classified SOP by Chief Counsel, the Tax Division may act on a compromise without obtaining the Chief Counsel's recommendation. In general litigation cases only, when the initial letter to the Tax Division from Chief Counsel fails to designate the case

as either SOP or Standard, the Tax Division will assume the case is classified SOP. Of course, you may always confirm the designation with an inquiry to Chief Counsel. In a refund suit (other than a trust fund recovery case under Code § 6672), when the letter from Chief Counsel fails to classify the case, you cannot assume the case is classified SOP, but must contact IRS Counsel and request the case be classified.

The recommendation of Chief Counsel is required in all cases before the Tax Division will act on a concession, except SOP cases involving liability under Code § 6672. If the Tax Division does not receive a recommendation regarding concession within 30 days from the date of the letter requesting the recommendation in a refund suit classified SOP, the Tax Division may process the case on the assumption that Chief Counsel does not object to the proposed concession, except where the proposed concession must be approved by the Associate Attorney General or referred to the Joint Committee on Taxation.

3. Taxpayers and/or periods not in suit

If the offer covers periods or taxpayers not in suit, the Tax Division will seek the recommendation of the Chief Counsel. Where a proposed settlement provides for the execution of a closing agreement, the appropriate IRS representative must review the closing agreement. This review should take place before any action is taken on the offer in order to avoid a situation where the Tax Division approves a settlement providing for a closing agreement that is unacceptable to the IRS. In

almost all cases, as when subsequent years are pending in the Appeals Office of the IRS, the IRS office involved will prepare the closing agreement. The Trial Attorney should also review the closing agreement to ensure that its terms are consistent with the terms of the proposed settlement under the Tax Division's jurisdiction.

4. The 45-day rule

On occasion, the Chief Counsel fails to provide a timely response to our request for their views on a settlement proposal. In those cases, the Section Chief may tell the Chief Counsel, in writing, that unless the Tax Division hears from that office within 45 days, the Tax Division will proceed on the assumption that the IRS does not object to the proposed settlement. A letter to Chief Counsel invoking the 45-day rule is in Appendix G. Before the Tax Division can determine that the Chief Counsel has failed to respond in a timely manner, the Chief Counsel must have received (either in advance of or with the 45-day letter) everything needed to review the proposed settlement, including a copy of the Trial Attorney's draft compromise memorandum.

Further, the Chief Counsel is considered to have responded to the 45-day letter if, within the 45-day period, the Tax Division receives either (1) a recommendation or (2) a request for additional time and an estimate as to when the recommendation will be received. This 45-day procedure is not applicable to settlements that must be approved by the Associate Attorney General or referred to the Joint Committee on Taxation, or that include a taxpayer or period not in suit. In those

cases, action on the settlement proposal cannot proceed without the IRS's explicit recommendation.

F. Settlement and concession memoranda

Trial Attorneys recommending settlement or concession should set forth their recommendation and their reasons in a memorandum. A model memorandum is contained in Appendix H. The first page of the memorandum should summarize the nature of the case, issues, and amounts involved. Because the amount involved in the litigation usually includes unpaid underpayment interest on taxes owed, or unpaid overpayment interest on refunds to taxpayers, it is helpful in determining settlement authority, as discussed in *Part II*, if the memorandum indicates the amount of tax and penalties owed, or the amount of tax and underpayment interest paid by the taxpayer. In addition, the Trial Attorney should detail the treatment of interest under the proposed compromise or concession. Any recusal should also be prominently noted (and the recusal should be recorded in TaxDoc as well).

The first page of the memorandum should also contain the date of the offer and of any amendments. Next, the memorandum should state the Chief Counsel's recommendation (or designation as SOP). Remember, local IRS counsel may not have the authority to sign a recommendation letter on an offer that includes taxpayers or periods not in suit. See discussion at *Part III-E-3*, *above*. The Trial Attorney's recommendation should come after the IRS's recommendation.

The name, address, and telephone number of the taxpayer or taxpayer's representative must also appear in this part of the memorandum. The address on the memorandum is the address the Post Litigation Procedures Unit (PLPU) will use for any refund check that is due as the result of the settlement. Therefore, it is important that the address be correct.

While there is no required format for the body of the memorandum; generally it should set forth: (1) the question(s) presented; (2) the terms of offer; (3) the statutes and regulations involved; (4) the jurisdictional statement, providing the facts establishing that the refund claim and suit are timely in whole or in part; (5) the statement (which normally explains the facts); (6) the discussion, which should include any relevant comments by the court; and (7) the conclusion. In a longer memorandum, it is helpful to include a summary or overview up front.

The questions presented section should identify the substantive questions the reviewer must consider to evaluate the propriety of the settlement. A general statement like "should the offer be accepted given the litigating hazards," adds nothing to the memorandum since the reader already knows that settlement is being considered based on litigating hazards or collectability. It is much more useful for the reader to learn something about the case in your statement of the issue. For example: "Are the hairdressers who work for the taxpayer employees or independent contractors?" The questions presented and

the terms of the offer may be combined, as, for example: "Whether the taxpayer adequately substantiated claimed travel and entertainment expenses for 2000-2001, where no contemporaneous log or other documentation was kept? Under the proposed settlement, the taxpayer concedes 2000 (involving a total of some $100,000 in claimed expenses) and the Government concedes 50% of the $200,000 involved with respect to 2001."

In a refund suit, the jurisdiction section of the memorandum should contain the facts needed to verify the court's jurisdiction. Those include the filing date of the original return, the existence of any extensions of the statute of limitations for assessment and collection of tax period(s) in suit, the filing date of the refund claim, the date of any IRS action on the claim, the filing date of the complaint, and the applicability of any Code § 6511(b) limitations regarding the proposed settlement overpayment. In preparing this section of the memorandum the Trial Attorney should obtain from the IRS a current transcript of account, to make sure that no developments (*e.g.,* a tentative refund) affect the amount in controversy, or should be addressed in considering the settlement.

The discussion section of the memorandum should, in a litigating hazard settlement, explain the strength and weakness of the Government's position with respect to all issues involved in the case (or all issues covered in a partial settlement). The memorandum should also address any issues identified in the IRS's recommendation. If the

Trial Attorney believes that the IRS's analysis on a particular issue is wrong or irrelevant, it is very helpful to explain why.

Despite the efforts to make sure that the terms of settlement are clear at the time the offer is made and acknowledged, occasionally additional matters need to be addressed in the acceptance letter or by way of counteroffer. The memorandum should clearly identify these issues. (The Trial Attorney may also seek an amended offer which clarifies or adds terms to the offer to cover the additional matters.)

When preparing the memorandum, make it as easy as possible for those who must also add their recommendation or act on the offer to check the accuracy of the statements made in the memorandum or to review the relevant documents. Documents referenced in the memorandum should be either attached as exhibits to the memorandum or tabbed in the files that are sent forward with the memorandum. Alternatively, or additionally, the Trial Attorney can identify the DMS document number(s), or location, including the subfolders in the case file, where supporting documentation is found.

G. Settlement Checklist

The Trial Attorney should submit a completed Settlement Checklist (App. A), or an equivalent form approved by a Section Chief, with the memorandum. The purpose of the checklist is two-fold: (1) to set out, on one page, the information (*e.g.,* time limit, date of offer), which makes it easier for the person reviewing the settlement to see at

a glance what is involved; and (2) to remind the Trial Attorney of points to consider and/or address in connection with settlement.

H. Other Documents Needed

In addition to the Trial Attorney memorandum, the following information is normally needed to consider an offer:

- Up-to-date IRS transcripts of the taxpayer's account.
- IRS administrative records pertaining to the periods and issues in suit.
- The Chief Counsel's settlement recommendation in non-SOP cases.
- The Department of Justice files relating to the ongoing litigation.
- Pertinent discovery materials.
- In a collectability settlement, a completed Collection Information Statement, either IRS Form 433-A (App. V-1) and or IRS Form 433-B (App.V-2), IRS report on Collection Information Statement, income tax returns for the past five years, and any other information gathered relating to the taxpayer's assets or income.
- A collateral agreement (App. W-1) with an Annual Income Statement (App. W-2), if part of a collectability settlement.
- In a case within the Trial Section's settlement authority, an action sheet setting out the action the Trial Attorney is recommending to the Section Chief. *See* App. I-1 (compromise) and App. I-2 (concession).

- In a case within the Trial Section's settlement authority, the appropriate letters advising opposing counsel and the IRS of the action. See *Part III-I*, *below*.
- If the settlement results in a refund, the Division's Post Litigation Procedures Unit (PLPU) must be copied on the acceptance letter and the attorney should prepare a Form M-4457 (App. S-1).

I. Acceptance Letters and Other Correspondence

The offer and acceptance form a contract between the parties. The Trial Attorney should carefully tailor an acceptance letter to obtain the negotiated for settlement. Trial Attorneys should modify form letters to fit the case and the offer being accepted. Model letters and stipulations useful in compromises are in the appendix:

Model Documents	
Appendix	Description
K-1, K-2	Rejection Letter to Proponent & IRS
L-1, L-2	Acceptance Letter to Proponent & IRS - Overpayment
M-1, M-2	Acceptance Letter to Proponent & IRS - Payment Due Government
N	Acceptance Letter to Proponent in a § 6226 Partnership Proceeding
O	Stipulation for Dismissal – U.S. Defendant
P	Stipulation for Judgment – U.S. Plaintiff
Q	Stipulation for Dismissal & Judgment – U.S. Counterclaimant
R	Concession Letter to Opponent

The Trial Attorney or attorney from the Office of Review, as the case may be, also is responsible for advising Chief Counsel in writing

when liens are to be released, or property is to be discharged from a lien, or when the assessment(s) is to be partially of fully abated.

In addition, when a compromise is within the authority of the Trial Section or Appellate Section, it is the responsibility of the Trial Attorney to ensure that the documents necessary to process the payment, including the form M-4457 (App. S-1), are prepared promptly and forwarded to the appropriate office (App. S-2) so that the terms of the settlement are implemented. *See* Tax Division Directive 85 (App. D-8). In all other cases, it is the responsibility of the Office of Review to prepare the form M-4457 and coordinate with the Trial Attorney on implementing any other terms of the settlement. The Trial Attorney, or the Office of Review attorney, handling the case is responsible for verifying the correctness of refund checks issued to taxpayers. *See* Tax Division Directive 113 (App. D-5).

J. When Full Payment Is Made

When the taxpayer has fully complied with the terms of the compromise, the Trial Attorney or Tax FLU should take all necessary actions to carry out the Government's obligations under the settlement, such as:

(1) File a satisfaction of the judgment and release judgment liens, including abstracts, or dismiss the Government's claim;

(2) Request that the IRS release liens against the taxpayer for the liability at issue, or discharge the fund or property involved from the liens against the taxpayer for the liability at issue; and

(3) Advise the IRS that the case is fully paid under the terms of the compromise (directing the IRS to abate any unpaid balances, as provided by the compromise) and close the case, advising the IRS and the United States Attorney that the case is closed.

K. Default on a Compromise

Normally, the Section Chief has the authority to determine when the taxpayer is in default on a compromise. In the event of a default, the Trial Attorney should notify the taxpayer's counsel or the taxpayer that the taxpayer is in default and request that the default be cured, generally within 21 days or another cure period set forth in the settlement agreement. If the taxpayer does not timely cure the default, the Trial Attorney should seek the appropriate remedies.

L. Submitting a Recommendation to the Office of Review

A recommendation submitted to the Office of Review should be accompanied by the Settlement Checklist (App. A), Trial Attorney memorandum (App. H), the Section's recommendation, and the views of Chief Counsel (except for settlements in SOP cases). Also, the trial section must transfer the case in TaxDoc to the Office of Review. In a case submitted by the Appellate Section that was handled by a Tax Division trial section, the Appellate Section should also obtain the recommendation of the Civil Trial Section in which the case originated.

The referring section should obtain and check any computations required under the compromise or concession.

If the Office of Review determines that further factual development of a case is necessary, or that additional issues should be addressed, generally, the referring section is responsible for whatever additional work is necessary.

The Trial Attorney should consult with the Office of Review before making representations to the court concerning the time necessary to act on a settlement, and should furnish the Office of Review with a draft of future statements before they are submitted to the court.

M. Responsibility of Assistant U.S. Attorneys

An Assistant United States Attorney assigned to handle a case on behalf of the Tax Division is responsible for preparing a settlement or concession memorandum in the same manner as a Tax Division attorney. The memorandum should be addressed to the Assistant Attorney General and should be sent to the Chief of the section concerned, together with all necessary attachments. The offer should then be forwarded with the section's recommendation.

N. Issuance of Refunds

1. Preparation of Form M-4457

Once an offer has been accepted or a concession approved that will result in an overpayment, the Tax Division prepares and sends directly to the Service Center (App. S-2) a payment authorization memorandum, Form M-4457 (App. S-1), directing the issuance of a refund pursuant to a compromise. A copy of the payment authorization memorandum is sent to the appropriate Chief Counsel office, and another copy is sent to the Tax Division's Post Litigation Payment Unit (PLPU). In refund suits, it is generally preferable to have the parties agree to the amount of the overpayment and the related computations prior to an offer being accepted. In partnership proceedings, a settlement or concession will determine adjustments at the partnership level. Computations of liability at the partner level should be left to the IRS.

When settlement or concession is within the Section Chief's authority, the Trial Attorney should prepare the M-4457. In all other cases, the Office of Review will prepare the Form M-4457. Preparation of the M-4457 includes review of a current transcript of account before submitting the Form M-4457 to the Service Center to ensure that previous payments have not already been refunded or credited to other liabilities. The account information also is necessary to verify the interest calculation, which involves knowing the date tax is due and the date of payment, as well as the amounts of each.

The authorization to issue a refund must be clear and precise. For example, if you are settling a case involving three years on the basis of overpayments of 50% of the tax and assessed interest paid, the Form M-4457 must specify the amounts of the refund of tax and assessed interest paid for each year. For another example, there may be instances where overpayments for some years trigger deficiencies for other years, and the settlement uses the mitigation provisions of Code §§ 1311, et seq. to prevent an excessive refund. In that situation, the Form M-4457 will typically direct that the deficiencies be offset against the overpayments, and only the net amount refunded. Unless great care has been taken, however, the Service Center may simply allow the overpayment, ignoring the deficiencies because they have not been assessed.

Where the refund will exceed $1 million, the taxpayer may request that the refund be made by electronic funds transfer (EFT). In those cases, the Trial Attorney should have the taxpayer complete an IRS Form 8302 (App. S-3), which should be forwarded to the Service Center along with the Form M-4457. In such cases, along with the Form M-4457, include a specified amount of statutory interest computed to the approximate date of the Form M-4457, plus unspecified additional statutory interest accruing from such date. Attach to the M-4457 the statutory interest computation and a request that the IRS verify the specified amount of statutory interest and notify the Tax Division of any difference.

2. Verifying Correctness of the Refund Check and Notice of Adjustment

Trial Attorneys are responsible for making sure that refund checks issued because of compromises, concessions, or judgments in our cases are accurate, both as to the principal amount of the refund and as to statutory interest, as a taxpayer who gets too much is unlikely to complain. *See* Tax Division Directive 113 (App. D-5).

The IRS sends refund checks, together with the notice of adjustment and statutory interest computation, to our PLPU. PLPU will send the Trial Attorney (or Office of Review, in cases handled by that Office) a copy of the notice of adjustment and statutory interest computation. (If the Trial Attorney is not scheduled to be in the office within the next week, the PLPU will consult with the Section Chief or Assistant Section Chief.)

The Trial Attorney (or Office of Review) should promptly review the notice of adjustment to make sure that it complies with the terms of settlement and the M-4457. The Trial Attorney (or Office of Review) also should review the statutory interest computation. If the IRS allows excessive amounts of interest, the Government only has a short window to recover those amounts through an erroneous refund action. To facilitate the verification of the amounts of refund checks, Trial Attorneys should prepare an interim computation of the statutory interest payable as of the date the Form M-4457 or judgment is prepared. If an interim computation has been prepared, when the

statutory interest computation is received from the Service Center, the Trial Attorney needs to update the interest computation (generally to the date of the refund check) and compare the updated computation with the Service Center computation to see if there is any significant discrepancy. If the Trial Attorney is unable to verify the correctness of the refund check, or resolve discrepancies in the computation of the tax or statutory interest, the Trial Attorney should seek the assistance of one of the Tax Division's Recomputation Specialists.

PLPU will not forward the refund check (and notice of adjustment and statutory interest computation) to taxpayer's counsel until the Trial Attorney or Office of Review advises that the check is in the correct amount. Because additional interest will be owed if the check is not promptly delivered, timely review is imperative.

O. The Tax Division Offer List

For many litigants, one of the incentives to settle is to reach a quick and certain resolution, rather than face a long drawn out court proceeding. The Government's ability to act quickly, or not, may affect the willingness of current and future litigants to settle. It is, therefore, in the Government's interest, and one of a Trial Attorney's responsibilities, to process offers quickly and to make sure that the person with authority to act on an offer has all the necessary information to act quickly as well.

The Office of the Assistant Attorney General receives a periodic TaxDoc report that lists, by section and attorney, cases with offers pending, the date the offer was received, and what has happened (or not happened) since that time, including the section's explanation of why we have not yet acted on an offer. The report allows Tax Division management to ensure that we are processing our offers with reasonable diligence and, if necessary, to prod us when we are not. All settlement offers should be logged into TaxDoc. Subsequent actions on the offer (*e.g.,* requesting and receiving the views of Chief Counsel; action by the Trial Section; action by the Office of Review) should also be entered into TaxDoc.

It should be the goal of every Trial Attorney to consistently negotiate and process good settlements in a timely fashion; some suggested ways to achieve that goal include:

(a) Discuss potential offers with taxpayer's counsel, exploring all the issues that could arise, and advise opposing counsel to address all of the issues in the offer.

(b) Discuss potential offers with Tax Division supervisors during the negotiation. Section managers can provide guidance and experience in obtaining offers that are more likely to be approved.

(c) Taxpayers sometimes make offers early in the case – before discovery when we know little or nothing about the case. The Trial Attorney will need to obtain information before the offer can be acted

upon. Advise opposing counsel to provide the information with the offer without waiting for a formal discovery request.

(d) Keep the IRS and Chief Counsel informed during settlement negotiations. In a Standard case, get Chief Counsel's informal views and ask for assistance in identifying the details that an offer should cover. This will not only improve the quality of the offer but also (a) cut down the amount of time it takes Chief Counsel to consider the offer and (b) alert the Trial Attorney to issues that Chief Counsel believes should be addressed. Promptly send the Chief Counsel the offer and follow up with additional information, including a copy of the Trial Attorney's draft memorandum, if it would be helpful.

(e) Reject offers quickly in the appropriate case. On occasion, a Trial Attorney will leave a not-so-good offer pending while attempting to negotiate a better offer. Sometimes this is surely a good approach. In other instances, however, leaving the prior offer pending may impede negotiations.

IV. EVALUATING SETTLEMENT OFFERS

A. Single Issue, Non-Valuation Case

In evaluating a proposed settlement in a case presenting a single non-valuation issue that, if litigated, would result in either a complete victory or a complete defeat for the Government, the Trial Attorney needs to evaluate the chance of prevailing given the governing statutes, regulations, case law, burden of proof, documentary and testimonial evidence, etc.

B. Adding in Concerns About Collectability

In the same case presenting a single non-valuation issue in a suit where the Government has not been fully paid, the Trial Attorney should also evaluate whether the amount of the IRS's tax claim far exceeds the value of the taxpayer's assets. When the IRS's claim far exceeds any potential collection (assuming the Government prevails on the merits), the starting point for analyzing a settlement is the value of collectible assets, including payment from future earnings and income.

C. Multi- Issue and Valuation Cases

Multi-issue and valuation cases require a different analysis because the Government is not faced with a zero - sum proposition. In a multi-issue case, the Trial Attorney must evaluate the merits of each issue, both individually and in conjunction with each other. In a

valuation case, a court can determine any value, and need not choose the value proposed by either the taxpayer or the Government. The Trail Attorney, therefore, needs to evaluate multiple potential outcomes.

V. COMMON ISSUES IN TAX DIVISION SETTLEMENTS

A. Collection Cases and Counterclaims

1. What to Consider

Even though the Government may have a strong case on the merits, absent other considerations, Government lawyers should not expend substantial resources to obtain an uncollectible judgment. Instead, it may be more efficient to negotiate a collectability settlement. An offer in a collection case, as well as any case involving a counterclaim, should provide specific terms for payment and/or other collection. If payments are to be made over time, the offer should specify a schedule of payments, whether deferred payments will bear interest, actions to be taken when the final payment is made, and the consequences of default. If assets are available, consider negotiating for some collateral to secure the deferred payment obligation. If paying by check, payment by certified or cashier's check is preferred. When payment is by personal check, we have to wait until confirmation that a check cleared before taking further action, such as releasing a lien or dismissing the case. It is now possible for payments to be made by credit card (App. T) or direct debit of periodic installments from a checking account. It is also possible to make payment by wire transfer. (For more information on payment options, please contact the Tax FLU.)

In order to analyze the advisability of a settlement based on limited collectability, the Trial Attorney should gather information from several sources to support a conclusion that collection is limited to a certain amount. For example:

(a) Discuss the case with the IRS

Discuss the case with the Revenue Officer or someone in Technical Support (formerly Special Procedures) who has already made collection efforts. (App. W-6 & W-7) Find out what that person has already done, what he or she is doing now, and what he or she believes the collection potential to be.

(b) Check that notices of federal tax lien have been filed

Confirm that liens have been filed and/or re-filed, in each appropriate location, and identify dates on which liens will release the IRS takes no further action.

(c) Get copies of income tax returns

Ask the IRS (or, if necessary, the taxpayer) for copies of income tax returns, beginning with the period in litigation and continuing through the taxpayer's most recently filed return. When reviewing the returns, pay attention to assets held at the time of litigation, and sources of income that were reflected on earlier returns but disappear on later returns. Disappearing assets may indicate that the taxpayer

has transferred property, possibly for inadequate consideration, or is hiding assets. In general, you will need the returns for at least the three most current years (five is preferred) to make a reasonable assessment of the taxpayer's current financial condition. If tax returns are not available, ask the Service for transcripts of account for the same periods. As the suit progresses, obtain copies of the income tax returns filed annually.

(d) If the taxpayer has failed to file returns

The taxpayer should be encouraged to submit delinquent returns to the IRS before an offer is made.

(e) Obtain the appropriate Form 433

The taxpayer's response to Question 16 on Form 433-A and Question 12 on Form 433-B, relating to transfers of assets, should cover the longer of the period from the time the tax liabilities sought to be compromised accrued or the last 10 years (rather than only the last 10 years). The Trial Attorney should include a DOJ Privacy Act Statement (App. V-3) when sending a Form 433. Ask the IRS to assign a Revenue Officer to verify the Collection Information Statement whenever the Government is asked to make a substantial concession based on collectability. The Trial Attorney should discuss whether to have the financial information verified with their supervisors. When considering compromise of a judgment, Rule 69 interrogatory answers containing

up-to-date financial information may take the place of a Collection Information Statement.

(f) Obtain loan applications

Loan applications and other information provided by the taxpayer may be available from the taxpayer or Government agencies such as the SBA.

(g) Examine available third party information

Examine public records information from sources such as Westlaw and Lexis/Nexis.

(h) Waiver of deductions or credits

The waiver for federal tax purposes of: (1) any deduction for the payments made pursuant to the settlement; (2) all or a portion of taxpayer's loss carryovers; or (3) all or a portion of taxpayer's credit carryovers can be sought as additional payment to the Government. In a bankruptcy settlement, an agreement to a reduction of the basis of the assets of a reorganized debtor might provide additional consideration for the settlement. Such agreements can be obtained with the use of a collateral agreement regarding waiver of carryovers (App. W-4) or basis (App. W-5).

2. Timing of Payments

(a) Lump sum and periodic fixed amounts

A settlement which requires payment should specify the amount and timing of all payments. In general, payments made at or near the time a settlement agreement is reached provide greater certainty of collection and require fewer resources to monitor compliance. If the settlement includes an installment or deferred-payment agreement, the unpaid amount generally should include statutory interest from the date of acceptance of the offer. The offer should also specify the timing of future payments. It is advantageous to obtain some type of security to decrease the likelihood of default, such as retaining or obtaining liens on property and/or entering judgment for the full amount of the liability which will be marked satisfied only when the settlement amount has been paid in full. Originals of legal documents, such as mortgages, notes, letters of credit, and insurance policies, provided as security should be preserved in a Tax Division safe, and the Trial Attorney should prepare a memorandum to the file describing where the document is stored. For a model acceptance letter when payment is due to the Government, *see* App. M-1.

(b) Collateral Agreements

Collateral agreements enable the Government to recover part or all of the difference between the amount of the offer and the liability settled. Collateral agreements fall into two categories: Collateral

agreements based on future income (App. W-1) and those by which a taxpayer gives up present or future tax benefits (App. W-4 & W-5).

The Trial Attorney should not seek a collateral agreement merely because an unlikely event may occur, such as the winning of a lottery or the inheritance of assets. If, however, the Trial Attorney believes that a substantial inheritance is reasonably likely to occur, the Trial Attorney can negotiate for a collateral agreement to capture some part of that inheritance.

Under the terms of a future income collateral agreement, a taxpayer is obligated to pay, for each year the agreement is in force, graduated percentages (generally ranging from 20 to 50%) of "annual income" in excess of a threshold amount or floor. *See* App. W-1, Collateral Agreement – Future Income – Individual and Corporation. Taxpayers sometimes ask what they can do in order to avoid being subject to the terms of a collateral agreement for a period of years. In some cases, an appropriate alternative is for the taxpayer to increase the up-front cash payment to an amount that will fairly substitute for the potential amount that would be paid pursuant to the collateral agreement, reduced to present value.

Where the taxpayer has incurred net operating losses or capital losses for years ending before the date on which the offer will be accepted, and/or the taxpayer has any unused credits from any of the prior years, a collateral agreement waiving any carryover of these losses and credits should be considered. *See* App. W-4. Likewise, in a

bankruptcy settlement, an agreement to a reduction of the basis of the assets of a reorganized debtor might provide additional consideration for the settlement. *See* App. W-5. This type of collateral agreement should be used only when the taxpayer is not executing a collateral agreement as to future income as a part of the settlement, since the collateral agreement as to future income contains a waiver of carryover of losses and credits.

3. Receipt and Monitoring of Payments

The Tax FLU monitors the receipt of payments which are directed to the Tax Division and will notify the trial section in the event further court action needs to be taken, such as after default. In order for Tax FLU to be aware of a payment due, a disposition code requiring payment to the Government must have been entered in TaxDoc. As soon as a settlement is approved, the Trial Attorney should ensure that the proper disposition information is entered in TaxDoc.

(a) Wire transfer, automatic periodic debit, credit cards

Taxpayers can make payment by electronic funds transfer (EFT) via Fedwire, credit card, and debit from a checking account. When a payment exceeds $50,000, use of Fedwire is the preferred form of payment. When payment will be by Fedwire, the trial attorney should coordinate with the Tax FLU to obtain the most up to date instructions. Payments can also be made by debit from a checking account or by credit card. Debit payments can be one-time payments or monthly

periodic payments. Taxpayers wanting to make credit card or debit payments should be directed to www.Pay.gov to register and then to the Department of Justice page in Pay.gov to access the form for Civil Debt payments. Taxpayers will need a CDCS number to complete the form. Trial attorneys and taxpayers may contact Tax FLU for assistance in obtaining a CDCS number. When a taxpayer would prefer to complete paperwork for a credit card or debit payment, a taxpayer can complete and submit to the Tax FLU a credit card payment authorization form (App. T) or an debit authorization form (App. U).

Payments due under a future income collateral agreement should be directed to an IRS Collection Advisory Group (App. W-6 and W-7).

(b) Check

The taxpayer should be directed to make payments by means of a cashier's or certified check, payable to the "Department of Justice." If sending the check by any delivery method other than the U.S. Mail, such as FedEx or UPS, the payment should be sent to:

Tax Flu, Office of Review
555 4th Street, NW
Room # 6647
Washington DC 20001

If sending the check by U.S. Mail the payment should be sent to:

Tax Flu, Office of Review
P.O. Box 310
Ben Franklin Station
Washington DC 20044-0310

B. Refund Suits

In evaluating offers in refund suits, the Trial Attorney or a supervisor may encounter questions not considered earlier in the litigation. Sometimes, the questions and the attendant answers derail a settlement. Common issues of this sort include offsets, equitable recoupment, and application of the mitigation provisions. It is best when the parties discuss such issues in the context of the settlement and the offer can then explain how the taxpayer proposes to treat the issue in the settlement. Almost always, when such issues are raised after an offer has been submitted, analyzing the issues and obtaining answers to those questions slow down the settlement process, frustrating taxpayers, counsel and the courts. Some of the common issues are:

1. Offsets Relating to the Tax Years in Suit

A taxpayer is entitled to a refund only if it overpaid its tax liability. *Lewis v. Reynolds*, 284 U.S. 281 (1932). In *Lewis v. Reynolds*, the Court approved treating a refund suit as a suit "in the nature of an action for money had and received," with the consequence that "the ultimate question presented for decision . . . is whether the taxpayer has overpaid his tax." The Court held that the statute authorizing refunds "necessarily implied" that the Government in defending a refund suit had the authority to reexamine the taxpayer's return – even if the statute of limitations on assessments had otherwise expired – since "[a]n overpayment must appear whenever repayment is

authorized." 284 U.S. at 283. Accordingly, when a taxpayer sues for a refund, regardless of the issues raised by the taxpayer in the suit and administrative claim for refund, the Government can seek to reduce any resulting overpayment by challenging other items relating to the years in suit. Neither the word "offset" nor "setoff" appears in the Supreme Court's opinion. Nevertheless, "offset" is a word often used to refer to such an adjustment in the Government's favor which reduces the taxpayer's recovery.

In the context of *Lewis v. Reynolds,* offsets can only be asserted with respect to the tax years (or periods) and types raised by the taxpayer in the complaint. For example, when an estate representative sues for a refund based on a challenge to the IRS's valuation of real estate owned by the estate, the Government may seek to offset any refund which would result if the plaintiff prevailed. This is done by challenging, in good faith, the valuation of art work also owned by the estate, even if the IRS did not challenge that valuation, or by challenging a deduction claimed by the estate for claims against the estate which have not been substantiated.

Another example of things to look for is when the taxpayer has an unpaid liability for which the statute of limitations on assessment or collection has passed, but has now requested a refund. That otherwise-barred liability can still be asserted as an offset against a refund for the same tax period. The Revenue Agent who worked the case is often a good source of information for potential offsets as the agent may know of issues raised in subsequent years which (but for limitations) could

and would have been raised for the suit years. Such issues could be made the subject of offsets.

Asserting an offset is not appropriate in every situation. Offsets should not be asserted with respect to issues for which the IRS and the taxpayer have signed a Form 870-AD (or any equivalent AD agreement) so long as the taxpayer's position is consistent with the Form 870-AD. To do so would violate the Government's agreement in the Form 870-AD. On the other hand, where either examination or Appeals has erroneously conceded all or part of an issue, and no Form 870-AD or closing agreement was executed, an offset would be appropriate.

The earlier in the litigation an offset is asserted the more likely a court will allow the offset issue to be litigated. *Cf., Routzahn v. Brown*, 95 F.2d 766, 771 (6th Cir. 1938) (upholding denial of tax collector's motion to amend "in view of the history of the controversy, the years that [had] elapsed since it arose, [and] the change in its character wrought by the amended answer"); *Dysart v. United States*, 340 F.2d 624, 630 & n. 10 (Ct. Cl. 1965) (holding that equitable considerations cannot bar the Government's unconditional right to setoff where setoff pleaded at the outset; court distinguished the situation where the defendant failed to raise the setoff defense at the proper time); *Fisher v. United States*, 80 F.3d 1576 (Fed. Cir. 1996) (interest setoff asserted in first amended answer before judgment), and *Americold Corp. v. United States*, 28 Fed. Cl. 747 (1993) (defendant permitted to amend answer to assert setoff defense before judgment); *Principal Life Ins. Co. and Subsidiaries v. United States*, 75 Fed. Cl. 32, 34 (2007) (defendant not

permitted to raise offset in light of lapse of time and issuance of opinion by the court on the merits of plaintiff's claims).

At least one court has limited the availability of offsets to amounts which are assessable as tax, penalty or interest. *Pacific Gas & Electric Co. v. United States*, 417 F.3d 1375 (Fed. Cir. 2005), *rehearing* and *rehearing en banc denied* (January 13, 2006); Non Acq. 2006 -26 I.R.B. 1147, AOD 2006-26-02, 2006 WL 2830795. In that case, the Federal Circuit held that because overpayment interest is not an assessable amount, overpayment interest that was erroneously paid to the taxpayer more than two years before the litigation could not be offset against additional claims for overpayment interest for the same tax year now in suit. The Federal Circuit declined to consider whether the Government could prevail on the basis of "equitable recoupment," concluding that the argument was not properly before it. *Pacific Gas & Electric Co. v. United States*, 417 F.3d at 1385, n. 10. (See further discussion of equitable recoupment *below*.)

2. Equitable Recoupment

Equitable recoupment, which is sometimes also referred to as "offset" or "setoff," can arise in a refund suit where a taxpayer win would result in an adjustment favorable to the Government with respect to some other tax year as to which the period of limitations for assessment has expired. The doctrine of equitable recoupment may be applied to relieve inequities caused when a transaction is treated inconsistently under different taxes, such as the income tax and the

estate tax. It may also be applied with respect to one taxpayer and different years. An independent action for recoupment, however, is not sustainable. *United States v. Dalm*, 494 U.S. 596, 611 (1990); *see also O'Brien v. United States*, 766 F. 2d 1038, 1049 (7th Cir. 1985) ("[t]he party asserting equitable recoupment may not affirmatively collect the time-barred underpayment or overpayment of tax.").

"The government has "the same right 'which belongs to every creditor, to apply the unappropriated moneys of his debtor, in his hands, in extinguishment of the debts due to him.'" *United States v. Munsey Trust*, 332 U.S. 234, 239 (1947) (quoting *Gratiot v. United States*, 15 Pet. 336, 370, 10 L.Ed. 759). It is equally "well settled that the government retains its setoff right unless there is some explicit statutory or contractual provision that bars its exercise." *Applied Cos. v. United States*, 144 F.3d 1470, 1476 (Fed. Cir. 1998) (citing *Munsey Trust*).

In *Bull v. United States*, 295 U.S. 247, 262 (1935), the Supreme Court explained that "recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded" and, as such, "is never barred by the statute of limitations so long as the main action itself is timely." In *Reiter v. Cooper*, 507 U.S. 258, 264 (1993), the Court recognized, as in *Bull*, that a claim of recoupment involves "the setting off against asserted liability of a counterclaim arising out of the same transaction," and it relied on *Bull* in finding that such claims "are generally not barred by a statute of limitations so long as the main action is timely." *Id.* The Court in

Reiter accordingly allowed the defendant to assert an offset against the plaintiff's claim on the basis of an express statutory cause of action, even though the defendant's claim would have been time-barred if brought as an affirmative suit. The Court emphasized that the rationale for its holding in *Reiter* was "a general principle of recoupment applicable in other contexts," rather than "just a narrow holding" based on the particular statutory scheme involved there. *Id.*

In *Bull*, income had been included as an asset of the estate for estate tax purposes, and subsequently taxed as income to the estate. In a suit for refund of the income tax that was paid on that income, the estate was allowed recoupment for the estate tax previously paid. The doctrine has been applied in Federal tax matters ever since, to allow the bar of the expired statutory limitation period to be overcome in limited circumstances in order to prevent inequitable windfalls to either taxpayers or the Government that would otherwise result from inconsistent tax treatment of a single transaction, item, or event affecting the same taxpayer or a sufficiently related taxpayer. See generally *McConnell*, "The Doctrine of Recoupment in Federal Taxation," 28 Va. L. Rev. 577, 579-581 (1942). *See also United States v. Dalm*, 494 U.S. 596, 605-606 n.5 (1990); *Rothensies v. Electric Storage Battery Co.*, 329 U.S. 296 (1946); *Stone v. White*, 301 U.S. 532 (1937); *Coohey v. United States*, 172 F.3d 1060 (8th Cir. 1999) (allowed to recoup an unjust AMT credit after AMT tax in previous year disallowed).

Equitable recoupment issues may also arise with respect to compromise of a refund suit for estate taxes to preclude double deductions, etc. An estate's administrative expenses, as well as losses, can be claimed as deductions either on the estate tax return or on the income tax returns of the estate (or its successor(s)). These include, for example, interest incurred on the federal estate tax, payment of which is deferred under Code § 6166A. *See* Rev. Rul. 81-256, 1981-2 C.B. 183; Rev. Rul. 81-287, 1981-2 C.B. 184; and *see* Treas. Reg. § 1.163-9T (b)(1)(v). Similarly, attorney fees can be claimed as deductions either on the estate tax return or on the income tax returns. To preclude the allowance of those deductions a second time (or their offset against the sale price of property in determining gain or loss), Code § 642(g) provides that those deductions or offsets shall not be allowed for income tax purposes unless the taxpayer files a waiver of the right to claim the expenses for estate tax purposes. There are occasions, however, when the deductions have been claimed for income tax purposes, no waiver has been filed, and the statute of limitations on income tax assessments has run. In this situation, Rev. Rul. 81-287, *supra*, holds that equitable recoupment is applicable against a claim for refund of estate tax, where the estate seeks (or has been allowed) a double allowance.

Another common estate-income tax situation involving equitable recoupment occurs when the valuation or inclusion of an asset in the gross estate determines basis for income tax purposes. The Trial Attorney will need to consider if there would be any correlative income tax adjustments if the estate were to prevail. To illustrate: (1) has the

property in question been sold or otherwise disposed of? (2) if so, how was gain or loss reported? (3) is the period of limitations open or closed? It is good practice to obtain written confirmation of oral representations by the estate/beneficiaries. If the year in which a taxable disposition occurred is closed and additional income tax is due, the Trial Attorney should attempt to obtain a reduction in the estate tax refund equal to the additional income tax due under the doctrine of recoupment. If the year is open, the offer can provide for the filing of amended income tax returns that are consistent with the estate tax settlement.

Sometimes, this situation can best be handled using collateral agreements affecting basis (App. W-5), executed by the present holders of the property, whether the executor or administrator, heirs, beneficiaries, distributees, or donees. Those agreements are intended to protect the Government in the situation where the estate and/or beneficiaries have not yet disposed of the property in a taxable transaction.

Equitable recoupment also has been asserted (generally without any objection by the taxpayer) where a taxpayer seeks a refund of Railroad Retirement Taxes, and, were the taxpayer to prevail, FICA taxes would be due. Code § 6521 specifically provides for mitigation, *i.e.*, offset, in SECA (self-employment)-FICA (employer/employee) situations.

Finally, the Government is more likely to prevail on a claim of equitable recoupment when it is asserted early in the litigation.

Conversely, the Government is less likely to prevail when equitable recoupment is raised later. In *Principal Life Insurance Co. v. United States,* 75 Fed. Cl. 32 (2007), *reconsideration denied*, 76 Fed. Cl. 326 (2007), post-decision computations revealed adjustments to AMT that significantly reduced the taxpayer's recovery. The court did not allow the United States to reduce the overpayment to account for the increased AMT liability, stating that "plaintiff was entitled to be notified about the existence of these claims before it proceeded significantly with this litigation." 75 Fed. Cl. at 33.

3. Code § 6402 Offsets

Code § 6402(a) permits the IRS to offset any overpayments against other federal tax liabilities of the same taxpayer. Offset of tax overpayments against certain other liabilities are also permitted by Code § 6402(b) - (e). *See also,* 31 U.S.C. § 3728. Consequently, the offer and acceptance letters, or other settlement document, should not provide for a "refund," since the overpayment may in fact be credited to one of these other liabilities (of which the Trial Attorney may be unaware).

4. Mitigation – Protection Against Double Allowances or Deficiencies

To the extent that a case involves the question of whether an amount should be deducted, or income included, in year one or year two, resolution of the litigation will likely have consequences in years which

may not be in suit. Similarly, cases may involve questions affecting related taxpayers – for example, whether income is taxable to a trust or its beneficiaries, but only one or the other is a party in the litigation.

In these cases, the Trial Attorney must consider the mitigation of limitations provisions, Code §§ 1311-1314, to prevent double allowances in the suit year and the non-suit year, or a double exclusion of the same amounts from income of the trust and its beneficiaries. Application of the statutory mitigation provisions is limited to seven narrow "circumstances of adjustment" described in Code § 1312. The first four circumstances involve double allowances or disallowances with respect to the same taxpayer or "related" taxpayers:

(1) double inclusion of an item of gross income;

(2) double allowance of a deduction or a credit;

(3) double exclusion of an item of gross income; and

(4) double disallowance of a deduction or a credit.

Paragraphs (5) and (6) deal, respectively, with correlative deductions and inclusions for trusts and estates and legatees, beneficiaries, or heirs; or correlative deductions and credits for members of an affiliated group of corporations as defined in Code § 1504. The last provision in Code § 1312(7), a complex and opaque provision, concerns the basis of property after erroneous treatment of a prior transaction. *See Chertkof v. United States*, 676 F.2d 984 (4th Cir. 1982); *O'Brien v. United States*, 766 F.2d 1038 (7th Cir. 1985).

For purposes of mitigation, related taxpayers are defined in Code § 1313(c) as (1) husband and wife, (2) grantor and fiduciary, (3) grantor

and beneficiary, (4) fiduciary and beneficiary, legatee, or heir, (5) decedent and decedent's estate, (6) partners, and (7) members of an affiliated group of corporations (as defined in Code § 1504). Although related taxpayers generally have a common economic interest, not all taxpayers with identical economic interests qualify as "related" pursuant to Code § 1313(c). For example, a corporation and the individual who owns 100% of its stock are not "related" under Code § 1313(c). Additional conditions necessary for Code § 1311 to apply are set out in Code § 1311(b), which deals with maintenance of an inconsistent position, and correction not being barred at the time of the erroneous action.

Lastly, and of great importance in the context of settlements, a "determination" described in Code § 1313, which will permit relief under these provisions is specifically limited, by Code § 1313(a), to:

(1) a decision by the Tax Court or a judgment, decree, or other order by any court of competent jurisdiction, which has become final;
(2) a closing agreement made under Code § 7121;
(3) a final disposition by the Secretary of a claim for refund; or
(4) under regulations prescribed by the Secretary, an agreement for purposes of this part, signed by the Secretary and by any person, relating to the liability of such person.

Because an Attorney General compromise or concession is not a “determination” (as defined in Code § 1313), Tax Division settlements must otherwise protect against double deductions or double exclusions of income, etc.

The following illustrates the problem: First, assume that a taxpayer claims a deduction of $100,000 in 1994. On audit, the IRS disallows the deduction for 1994, but allows it for 1998. Taxpayer pays the deficiency for 1994, sues for refund, and, in 2004, the taxpayer prevails and the judgment in its favor becomes final. At that time, the three-year period for assessment as to 1998 has run. Since the taxpayer has obtained a judgment, the mitigation provisions would reopen for one year the period of assessment for 1998, so that the Government might assess and collect the resulting deficiency due to the double allowance of a deduction or credit pursuant to Code § 1312(2), both in 1994 as allowed by the court and in 1998 as allowed by the IRS.

Second, and by way of comparison, assume that the same deduction is claimed for 1994 and allowed for 1998, but the case is settled on the basis of allowance of a deduction of 50% of the amount claimed for 1994. Unless special provision is made as part of the settlement, the Government will not be able to assess and collect the resulting deficiency for 1998.

You can avoid this problem in several ways. One is simply to provide that the deficiency for 1998 is offset against the overpayment for 1994, and make sure that the Service Center actually carries out this instruction. The second is to make it a specific provision of the settlement that the taxpayer and the Government agree that the settlement constitutes a determination under Code § 1313(a) and a correlative deficiency may be asserted for 1998, based on the partial

allowance of the claim for 1994. This procedure was adopted and approved in *Hilton Hotels Corporation v. United States*, 29 AFTR 2d 72-1027, 7201 USTC par. 9325 (N.D. Ill. 1972). The third option is to execute a stipulation for entry of judgment as to whatever the settlement provides.

C. Employment Tax Classification Cases

1. Worker Classification

Cases about the classification of workers as employees or independent contractors raise unique issues.

The first issue to consider is the applicability of § 530 of the Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2885 (reprinted at 26 U.S.C. § 3401 note). Congress enacted § 530 as a temporary measure, but subsequently made it permanent even though it is not part of the Code. Congress passed § 530 in response to its concerns that the IRS pursued employee-independent contractor cases too aggressively. Application of § 530, and the additional litigation hazards it presents, may support a compromise or concession of the employee-independent contractor classification issue, even though absent § 530, the Government could easily establish that the workers were employees.

Second, in determining the amount involved, the Trial Attorney should check whether the IRS has correctly applied Code § 3509, which determines the rate of liability for an employer who fails to deduct and

withhold employment taxes. If the IRS failed to do so, we may need to concede part of the case, agreeing that the liability is less than asserted by the IRS.

Finally, if the classification of workers as employees or independent contractors is a continuing issue (often it is if the taxpayer is an ongoing business), it is difficult to settle without obtaining an agreement from the taxpayer to treat its workers as employees in the future. Future compliance is a valuable concession that the taxpayer can make without present out-of-pocket cost. In a future compliance settlement, it is important for the owners of the business to agree that, even if the form of business changes, the workers will still be treated as employees.

2. Employer Identification

Some cases involve so-called Professional Employer Organizations ("PEOs"). When a PEO is involved, the company filing the employment-related tax returns and performing some other human resources or benefits administration functions may not be the common law employer under Code § 3401(d), nor the statutory employer under Code § 3401(d)(1). In such cases, when negotiating a settlement or analyzing an offer, the Trial Attorney should consider whether others may be liable for the tax and whether the IRS has collected any of the unpaid taxes from another person.

D. Partnership Proceedings

Partnerships are not liable for federal income taxes. Rather, items of income, deduction, credit, and so forth are passed through to the partners, who report their allocable shares of these items on their own federal income tax returns. (For a discussion of how to determine the amount of a Government concession and the corresponding settlement authority within the Department of Justice, see the discussion at *Part II-K-4*, *above*.) Administrative and judicial procedures with respect to the handling of partnership income tax issues are currently set forth in Code §§ 6221-6234. These provisions were enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Pub. L. No. 97-248, Sept. 3, 1982 and sometimes are referred to as "TEFRA proceedings." Code § 6224(c), amended in 2002 to specifically include settlements reached with the Attorney General (or a delegate), provides three rules concerning settlements. First, it provides, unremarkably, that a settlement agreement binds the parties to the agreement. Second, it provides that if the Attorney General (or a delegate) enters into an agreement with any partner regarding partnership items, then any other partner has the right to a settlement on consistent terms. Third, it provides that the Tax Matters Partner (TMP) can, in limited circumstances, bind other (non-notice) partners to a settlement.

Examinations of partnership items are conducted at the partnership level. At the conclusion of a partnership-level examination, the IRS mails an FPAA (notice of final partnership administrative

adjustments), to the partnership's TMP for the year(s) examined. The FPAA adjustments to partnership items are final and conclusive, unless challenged by the timely filing of a petition for readjustment pursuant to Code § 6226. In a proceeding under Code § 6226, the court has jurisdiction over all partnership items and the allocation thereof among the partners, for the year(s) in suit, not just the items adjusted by the FPAA. Further, for partnership taxable years ending after August 5, 1997, the court has jurisdiction to make partnership-level determinations as to the applicability of any penalty, addition to tax, or additional amount that relates to the adjustment of a partnership item. Code § 6226(f). The court's determination is binding on all partners. The jurisdictional deposit under Code § 6226(e) generally is not a payment of tax. Treas. Reg. § 301.6226(e)-1(c). The deposit, however, is treated as a payment of tax for the purpose of calculating underpayment or overpayment interest pursuant to Chapter 67 of the Code.

The proceeding is governed by the rules of the presiding court. Code § 6230(l). The Court of Federal Claims (as well as the Tax Court) has adopted rules regarding partnership proceedings, found in Appendix F to the Rules of the United States Court of Federal Claims; Rule 7 governs settlements: http://www.uscfc.uscourts.gov/rules-and-forms. A Trial Attorney handling a case in the Court of Federal Claims should consult these provisions early in the settlement process.

The offer and acceptance letters (or other documents reflecting the settlement) should explain the manner in which the partnership

proceeding will be resolved. For example, the parties need to consider whether to terminate the court proceeding with a stipulation for dismissal, a judgment setting forth the agreed resolution, or otherwise. In general, all partners are treated as parties and are bound by the decision of the court. Unlike a refund suit, dismissal of an action "shall be considered as its decision that the notice of final partnership administrative adjustment is correct. . ." (Code § 6226 (c) and (h)). However, when the Attorney General enters into a settlement with a partner in a partnership proceeding, "the partnership items of [that] partner . . . become nonpartnership items." Code § 6231(b). As a consequence, the settling-partner is dropped from the proceeding and a one year period for assessment begins to run immediately. Complicating matters further, the TMP generally has no authority to bind any other partner to a settlement. Code § 6224(c)(3). Generally, each partner or the partner's counsel should sign the settlement documents.

The statute of limitations in which to make assessments against the partners in accordance with the agreed upon adjustments is suspended while the partnership proceeding is pending and for one year thereafter. Settlement allows the one year clock to begin ticking either because the proceeding becomes final (Code § 6229(d)) or because the settlement has converted partnership items into nonpartnership items (Code § 6229 (f)). The statute of limitations can be extended by the express terms of the settlement, but merely contemplating the IRS and taxpayers will ultimately enter into a closing agreement to wrap up both partnership computational adjustments and nonpartnership items

may not be sufficient. Consequently, the Trial Attorney should immediately inform Chief Counsel when a partnership proceeding is settled or when a settlement is entered into with a particular partner. *See Gingerich v. United States,* 77 Fed. Cl. 232 and 78 Fed. Cl. 164 (2007).

Because partnership proceedings do not involve the determination of tax liability of the partners, it is generally not advisable to agree to a specific computational adjustment of liability. The better practice is to agree to the partnership adjustments, allowing the IRS to make the computational adjustments to each partners' return, while the partners retain their rights under Code § 6230(c) to challenge computational adjustments. In some cases, it may be advisable to allow the partner-taxpayers and the IRS to enter into a closing agreement simultaneously with the completion of the settlement. When the parties intend that completion of a closing agreement is a condition of settlement, that term should be stated expressly in the offer and/or acknowledgment letter. *See Treaty Pines Investments Partnership v. Commissioner,* 967 F. 2d 206 (5th Cir. 1992). When an offer is conditioned on a closing agreement being reached, it is better practice to have the closing agreement drafted and approved by the IRS signatory before the offer is accepted. This approach avoids a post-settlement dispute about the terms of the closing agreement which, if not resolved, may mean there is no settlement. Thus, the Trial Attorney should cover this as part of the settlement process.

Finally, when the settlement includes a resolution of penalties, it is best to expressly preclude the partners from bringing partner-level refund suits raising partner-level challenges to the penalties, unless the parties intend that such challenges can be later raised in a refund suit. Although partner-level defenses are not at issue in a partnership proceeding, it makes little sense to compromise a penalty for less than the full amount as part of the quid pro quo of a settlement, if the partner can later challenge the penalty in a separate proceeding and obtain complete relief. A model acceptance letter is included as App. N.

E. *Ponzi* Schemes and the Like

Cases involving competition between tax claims owed by wrongdoers, such as embezzlers, swindlers, and fraudsters, on the one hand, and investors, dupes and victims of the wrongdoing, on the other, against a fund or other property, present some unique litigation hazards and policy considerations which must be accounted for in evaluating any compromise. Tax Division policy considerations arise from a desire to balance the legal right of the United States to collect taxes against the equitable and legal rights of the defrauded investors (willing participants or customers who were misled or defrauded) and victims (persons who did not willingly participate or willingly part with money or property, such as when there is theft, including embezzlement) of wrongdoing. The policy is contained in Tax Division Directive No. 137 (App. D-2). A further discussion of some of the issues and considerations which arise in such cases is set forth in App. Z.

F. Attorney Fees

The proposed settlement should explicitly address the taxpayer's right to claim attorney fees. Absent unusual circumstances, we should require that the offer provide that each party bear its own litigation costs, including attorney fees. Failure to resolve the attorney fees issue will vitiate the advantages of certainty and lower litigation costs served by settlement, especially if the principal issue in the fees dispute is

whether the Government's position on the issue settled was substantially justified. *See* Code § 7430.

G. Computations

Because tax and interest computations can be complicated, the results can be surprising – what you may think is a 50% Government concession may turn out to be a 90% Government concession, or *vice versa*. For example, when a taxpayer has prevailed in litigation, the post-decision computations may reveal adjustments in AMT that significantly reduce the amount of the taxpayer's recovery. Application of the AMT to the year in suit is generally recognized as an automatic computational adjustment that is triggered by the decision. *See*, *e.g.*, *Southeast Bank of Orlando v. United States*, 2 Cl. Ct. 530 (1983); *Estate of Bowers v. Commissioner*, 94 T.C. 582 (1990). In *Principal Life Insurance Co. v. United States,* 75 Fed. Cl. 32 (2007), *reconsideration denied*, 76 Fed. Cl. 326 (2007), however, the court did not allow the United States to reduce the overpayment to account for the increased AMT liability, because the AMT adjustment had not been raised in the answer. The difficulty with *Principal Life* is that the effect of adjustments in taxable income on AMT liability are not known until the merits have been resolved. Application of the AMT to the year in suit is simply one step in the final computation of the tax liability resulting from the issues on which the taxpayer prevailed.

In order to avoid surprises, particularly in cases where the taxpayer is a large corporation or a substantial amount is at issue, ask

taxpayer's counsel to submit a computation together with the offer or, if not with the offer, then if you think an offer is otherwise worthy of serious consideration, ask the taxpayer to supplement the offer with a computation. Regardless of which party prepares the computation, the computation should be scrutinized to be sure that it does not address issues that the taxpayer has not raised in its refund claim or suit (and that are thus barred by the variance doctrine). A settlement should not permit a taxpayer to achieve a better result than it could have obtained had it prevailed in the litigation.

The Trial Attorney should arrange for the taxpayer's computation to be checked either by the IRS or by a Tax Division recomputation specialist. While the Trial Attorney is not responsible for the arithmetic involved in a complex computation, the Trial Attorney is responsible for ensuring that the computation is conceptually sound and should always review any computation to make sure it makes sense and is reasonably correct. This applies equally to computations prepared by Government personnel.

H. Interest

The offer and recommendation for or against acceptance should be clear about any claim to special treatment of interest, such as interest suspension under Code § 6404(g). Terms such as "interest provided by law" or "plus statutory interest" are not appropriate to resolve claims of interest suspension or other special treatment, and will result either in a delay in processing an offer, rejection of an offer, or further litigation

about the terms of the settlement contract. When a settlement requires the Service Center to deviate from normal interest computation rules, the Trial Attorney must communicate this fact explicitly to Chief Counsel and the Service Center. When an extraordinary interest treatment is sought, the Trial Attorney needs to address the underlying facts required to obtain special treatment, *e.g.,* filing of a timely return, date of notice to taxpayer of audit, etc.

In refund suits, it is not a good idea to accede to a request that all of the overpayment be considered tax, and no part interest. Interest received is taxable, and recoveries of assessed interest or deductible taxes are taxable if previously deducted, but recovery of a nondeductible tax is not includible in income. And, in any "tax only" refund case settlement, the settlement agreement must provide that the amount refunded, or credited to the taxpayer in accord with Code § 6402, will be treated as the repayment of an amount paid to the United States on the date of the refund or credit.

A collectability settlement that does not provide for full payment usually should require the taxpayer to agree that no part of the payment is deductible for federal income tax purposes. Also, the offer should be clear about whether, at what rate, and from what date interest will run on any installment or deferred payments.

Some general principles regarding interest are set forth below. For a fuller discussion of interest, see App. Y.

There are basically two kinds of interest associated with tax overpayments: interest which has been assessed and/or paid with respect to a deficiency (sometimes referred to as assessed interest or deficiency interest), and statutory interest (interest which, pursuant to Code § 6611, runs on any overpayment of tax, penalty, or interest assessed and paid, or, since 1983, statutory interest which has accrued). Since January 1, 1983, interest is compounded and accrues on statutory interest pursuant to Code § 6622. (Prior to January 1, 1983, only simple interest accrued, and no interest accrued on statutory interest.)

The general rule is that statutory interest runs on an overpayment from the date of the overpayment to a date preceding issuance of the refund check by not more than 30 days. In the case of a credit, interest runs from the date of the overpayment to the due date of the amount against which the credit is taken. Code § 6611(b). For purposes of determining the allowance of interest, all payments of estimated tax are deemed to occur on the due date of the return.

The rules for accrual of interest on underpayments under Code § 6601 are similar to, but not always an exact converse of, the rules for interest on overpayments. The general rule is that interest runs on an underpayment from the due date until the date of payment. In income, estate and gift tax cases, etc., if notice and demand is not made within 30 days of filing of a waiver of restrictions on assessment, interest is suspended beginning immediately after the 30th day and ending with the date of notice and demand. Interest may be suspended for other reasons as well, as specified in Code § 6404. Interest runs on penalties

from the date of notice and demand for payment; no interest is due if the penalty is paid within 21 days of notice and demand (10 business days in the case of an underpayment in excess of $100,000). Code § 6601(e). In general, interest does not run on a claim while a bankruptcy proceeding is pending, unless the claim is over-secured.

In the case of an overpayment generated by a carryback for periods after October 1982, interest is generally computed from whichever of the following dates is the later: (a) the due date of the return for the loss year (determined without extensions), (b) the date a delinquent return for the loss year was received, or (c) the date the tax for the income year was paid, whichever is later. If the interest computation involves a carryback, the Trial Attorney should seek assistance from either a Tax Division Recomputation Specialist or an IRS complex interest specialist.

In collection cases, the IRS does not always assess accruing interest until it has been paid or there is some other activity on the account which causes an assessment of accrued interest. Accordingly, a Certificate of Assessments and Payments or a transcript will not necessarily reflect interest owing as of the date the certificate is prepared or transcript printed. Even if interest has been assessed, further deficiency interest continues to accrue on unpaid amounts.

VI. APPENDIX

Appendix to Settlement Reference Manual		
A		Settlement Checklist
B		Quick Reference Chart
C	1	Flowchart for Compromise – Joint Committee
C	2	Flowchart for Compromise – Associate A.G.
D	1	Attorney General Opinion 38 Op. 98
D	2	Tax Division Directive 137
D	3	Tax Division Directive 139
D	4	Tax Division Directive 116
D	5	Tax Division Directive 113
D	6	Tax Division Directive 83
D	7	AAG O'Connor Memorandum 6-29-07 (§ 6226 Settlements)
D	8	Tax Division Directive 85
E	1	Delegation to Assistant Chief, Civil Trial Section
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F		Acknowledgment Letter
G		Letter Invoking 45 Day Rule
H		Compromise Concession Memorandum
I	1	Action Sheet - Compromise
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J		RESERVED
K	1	Rejection Letter to Proponent
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L	1	Acceptance Letter to Proponent - Overpayment
L	2	Acceptance Letter to IRS - Overpayment
M	1	Acceptance Letter to Proponent - Payment Due Government
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Appendix to Settlement Reference Manual		
N		Acceptance Letter in a § 6226 Partnership Proceeding
O		Stipulation for Dismissal - U.S. Defendant
P		Stipulation for Entry of Judgment - U.S. Plaintiff
Q		Stipulation for Dismissal & Judgment – U.S. Counterclaimant
R		Concession Letter to Opponent
S	1	Form M-4457
S	2	IRS Addresses to Send M-4457
S	3	IRS Form 8302 - Electronic Deposit of $1 Million or More
T		Credit Card Payment Form for Tax Division
U		Pay.gov ACH Authorization Request
V	1	433-A (rev. 1/2012)
V	2	433-B (rev. 1/2008)
V	3	DOJ Privacy Act Statement
W	1	Collateral Agreement - Future Income
W	2	Collateral Agreement - Annual Income Statement
W	3	Collateral Agreement - Monitoring Letter to IRS
W	4	Collateral Agreement - Waiver of Carryovers
W	5	Collateral Agreement - Basis
W	6	Collection Advisory Group Addresses
W	7	Collection Advisory Group Contact Information
X		IRS Form 8821: Tax Information Authorization
Y		Interest
Z		*Ponzi* Scheme Considerations