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Tonya M. Scherer

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COMMENT

Alternative Dispute Resolution in the Federal Tax Arena: The Internal Revenue Service Opens Its Doors to Mediation

I. INTRODUCTION

Within the last few decades, it has become apparent that feelings among Americans concerning our legal system have sunk to a state of dissatisfaction. The causes of this dissatisfaction are numerous, but the most prevalent are: high litigation costs, extensive discovery procedures bordering on invasion of privacy, the time consumption for case preparation, and unsatisfactory results.¹ In response to this dissatisfaction, a number of federal agencies have begun to employ various methods of alternative dispute resolution (“ADR”) to facilitate timely and cost-effective settlements which are satisfactory to all parties.² The enactment of the Administrative Dispute Resolution Act of 1996³ has enhanced the recent trend toward the implementation of ADR procedures.⁴

The Internal Revenue Service (“IRS”), however, has been slow in its application of ADR techniques. This reluctance is primarily due to the success of its Appeals Division (“Appeals”) in settling taxpayer disputes. In effect, Appeals operates as an “alternative dispute resolution forum” within the IRS because the process allows taxpayers to contest a proposed tax adjustment through face-to-face settlement conferences with an IRS Appeals officer.⁵ This approach has produced an 85 to 90 percent success rate for settling disputed cases.⁶ Despite this success rate, the IRS has determined that the process could be improved by other, more narrow procedures that target specific types of tax disputes.⁷ In response to this determination, the IRS established several programs with a primary intent of producing more efficient resolutions.⁸ The most recent of these programs is the new

1. John F. Murray, *Mediation of Tax Controversies: Getting to 'Yes'*, 96 TAX NOTES TODAY 32-22 (1996).

2. Steven C. Wrappe, *The IRS Expands Use of Alternative Dispute Resolution*, 95 TAX NOTES TODAY 91-86 (1995).

3. 5 U.S.C. §§ 571-583 (1996); see also Thomas Carter Louthan & Steven C. Wrappe, *Building a Better Resolution: Adapting IRS Procedures to Fit the Dispute*, 96 TAX NOTES INT'L 91-86 (1996). The Act requires each agency to develop a policy for implementing ADR procedures in its administrative programs and in doing so, the agency is given broad discretion regarding the procedures of dispute resolution methods. *Id.*

4. Wrappe, *supra* note 2.

5. *Id.*

6. Louthan & Wrappe, *supra* note 3.

7. *Id.*

8. *Id.*

tax mediation program introduced by the IRS in Announcement 95-86 which establishes a one-year test for mediation in tax disputes.⁹

This Comment examines the development of the new tax mediation program, its procedures and application, and its current status. Part II reviews the Appeals process leading up to and including the choice of an avenue to resolution of taxpayer disputes other than litigation. Part III explores the new mediation program including the scope of the cases allowed, the requirements for initiating the process and the procedures for implementing the program. Part IV discusses the policy reasons behind the IRS' implementation of the specific procedures and criteria into the new tax mediation program. Finally, Part V is an update of the success and current status of the mediation program.

II. TAX DISPUTES AND THE RESOLUTION PROCESS

A. The Appeals Process

The heart of the United States tax system is the voluntary filing of tax assessments by individual taxpayers.¹⁰ If a taxpayer refuses to file a tax return or to comply with an IRS auditor's request for information, a tax dispute is deemed to have arisen and the IRS will use the information it has available to assess that taxpayer's taxes.¹¹ The IRS begins the Examination process through the Examination personnel ("Examination") initiating the preparation of an Examination Report. Examination then notifies the taxpayer of the dispute by mailing an Examination Letter.¹² Once the Examination Report is complete, a "30-Day Letter," which is essentially a bill and explanation, is sent to the taxpayer, and he has 30 days to respond.¹³ The taxpayer can appeal the results of the Examination Report by filing a protest letter with Appeals, a separate division of the IRS designed to be a neutral decisionmaker.¹⁴

The process Appeals employs consists of a face-to-face conference between the taxpayer, or his representative, and an Appeals officer.¹⁵ The Appeals officer reviews the facts, evidence and hazards of litigation to determine an acceptable settlement.¹⁶ Appeals enjoys a high success rate in its resolution of taxpayer disputes;

9. Announcement 95-86, 1995-44 I.R.B. 22.

10. Kirsten J. McDonough, *Resolving Federal Tax Disputes Through Alternative Dispute Resolution*, 48-JUN ARB. J. 38 (1993).

11. *Id.*

12. *Id.* The Examination Letter contains a statement of the amount of tax that is due or simply requests that information be furnished for specific items. *Id.*

13. *Id.*

14. *Id.* The Appeals process is commenced when the protest letter is filed. By being a separate arm of the IRS, Appeals has the authority to consider settlement offers that reflect the interests of the taxpayer and the IRS in light of the hazards that would arise should the case go to trial. The Appeals officer acts with more of a "judicial attitude" than as an advocate for the IRS. Louthan & Wrappe, *supra* note 3.

15. *Id.*

16. *Id.*

this is evidenced by a resolution rate of approximately 85 to 90 percent of all disputes that go through the Examination process.¹⁷

However, should the taxpayer decide not to file a protest letter, or if a settlement is not reached through the Appeals process, the IRS will issue a "90-Day Letter," or the Notice of Deficiency, signaling the termination of their efforts to resolve the dispute administratively.¹⁸ The file is then assigned to the District Counsel who prepares the case for litigation.¹⁹

B. The IRS Strives for More Efficiency

Although Appeals continues to be an effective resolution process, the IRS continues to strive for effectiveness and efficiency. As a result, the Service is considering various ADR procedures as a form of resolution for tax disputes. Despite the excellent track record of dispute resolution at the administrative level, the IRS has still directed its efforts toward establishing new procedures which target specific types of disputes so as to insure that the new procedures do not undermine the Appeals process.²⁰ Within the last six years,²¹ the IRS has implemented several individual programs; each utilizing traditional ADR techniques and each targeting specific disputes that arise in the tax arena. Those programs are: Advance Pricing Agreements ("APA");²² Delegation Order 236 (Rev. 2) and Delegation Order 247;²³ Accelerated Issue Resolution ("AIR");²⁴ Early Referral;²⁵ Competent Authority

17. *Id.*

18. McDonough, *supra* note 10.

19. *Id.*

20. See Wrappe, *supra* note 2; Louthan & Wrappe, *supra* notes 3, 6-9 and accompanying text.

21. See *infra* notes 22-28 for dates of promulgation of the ADR programs implemented by the IRS.

22. Rev. Proc. 91-22, 1991-1 C.B.526. The purpose of APAs was to enhance voluntary compliance with United States transfer pricing rules. This process allows the IRS and taxpayer to "prospectively agree on three issues: 1) the factual nature of the intercompany transactions to which the APA applies; 2) an appropriate transfer pricing methodology; and 3) an expected range of results from applying the methodology to the transactions." Louthan & Wrappe, *supra* note 3 (citing Rev. Proc. 91-22, 1991-1 C.B. 526 § 3.03). The most important benefits are certainty of tax treatment and time and cost savings. Louthan & Wrappe, *supra* note 3.

23. 1996-21 I.R.B. 7. Delegation Order 236 is available during the Examination process, prior to Appeals. It allows Examination personnel to settle rollover or recurring issues in prior or subsequent tax years, or the same tax period, for certain Coordinated Examination Program ("CEP") taxpayers. See *infra* note 41. This eliminates the need for the Appeals process. Louthan & Wrappe, *supra* note 3 (citing 1996-21 I.R.B. 7 § 2). To qualify, certain factors must be present in the tax year under examination. *Id.* Delegation Order 247 provides to CEP case managers the authority to accept settlement offers with respect to coordinated issues within the Industry Specialization Program ("ISP"), see *infra* note 45, and International Field Assistance Specialization Program ("IFASP"). Such a settlement must be reviewed by Examination and Appeals prior to approval. *Id.*

24. Rev. Proc. 94-67, 1994-2 C.B. 800. AIR is also available in the Examination process and allows CEP taxpayers to resolve issues by an agreement on the appropriate treatment for an issue for all years under Examination jurisdiction. In essence, this program allows resolution of issues that may come up for reconsideration in another examination cycle. Louthan & Wrappe, *supra* note 3 (citing Rev. Proc. 94-67, 1994-2 C.B. 800).

25. 1996-2 I.R.B. 15. This procedure allows CEP taxpayers to request the transfer of developed, disputed issues within Examination's jurisdiction to Appeals for resolution while remaining issues are developed in Examination. This process is expected to shorten the overall time of resolution. Appropriate issues include issues that are not designated for trial but are expected to accelerate the

Improvements;²⁶ and Arbitration.²⁷ The most recent addition to this list of acceptable ADR procedures in the tax field is Mediation.²⁸

Mediation is a "non-binding process which involves a mediator²⁹ or neutral third party who acts as facilitator to guide the parties to a negotiated agreement."³⁰ Mediation is generally considered the most favored ADR technique outside the tax arena.³¹

Tax Court judges in the past have indicated an interest in mediating factual issues either under Rule 124 or under their general discretion.³² However, a

resolution of the case without litigation. Louthan & Wrappe, *supra* note 3. Although early referrals were reserved for CEP cases only, the program has been extended to some non-CEP cases such as employment tax issues. *Id.* at n.39.

26. 1996-3 I.R.B. 31. Improvements have been made to Competent Authority procedures. The first is Simultaneous Appeals/Competent Authority Procedure. Louthan & Wrappe, *supra* note 3 (citing 1996-3 I.R.B. 31 § 8). In this procedure, taxpayers are allowed to seek simultaneous competent authority assistance, *see infra* note 44 describing competent authority assistance, and Appeals consideration of an issue. *Id.* This process is designed to shorten the time required for resolution. Simultaneous appeals may be requested in three situations. The first is after Examination has proposed an adjustment of an issue which the taxpayer wishes to submit to competent authority. The second situation is when a 30-Day letter has been issued by Examination and the taxpayer wishes to sever the issues and seek competent authority resolution of some and Appeals resolution of others. The final situation is when the taxpayer is already in Appeals and it is obvious the taxpayer will request competent authority assistance on an issue. *Id.* The second improved procedure is designated as Accelerated Competent Authority. This procedure allows a taxpayer to request that an issue raised by the IRS be resolved by competent authorities for subsequent tax years ending prior to the date of the request for competent authority assistance. *Id.* (citing 1996-3 I.R.B. 31 § 7).

27. Tax Court Rule 124 (1990). In 1990, the Tax Court promulgated Rule 124, allowing voluntary arbitration of factual issues. Louthan & Wrappe, *supra* note 3. Executive Order No. 12778 generally prohibits government counsel from entering into binding arbitration agreements in any area of the law; however, this prohibition does not apply to practice under Rule 124. *Id.* Arbitration has not been seriously considered for resolution of disputes outside of docketed Tax Court cases, but since its enactment, Rule 124 has been utilized in at least 20 cases involving factual issues. *Id.*

28. Announcement 95-86, *supra* note 9.

29. The "mediator" does not render a judgment in the dispute, rather he simply (1) meets with the parties, together and individually; (2) focuses on the key issues in disputes and each party's individual interests and goals; and (3) suggests potential options to help the parties find a mutually advantageous solution. John M. Beehler, *Mediating with the IRS*, THE TAX ADVISOR 1996 WL 9338442. The goal of the mediator is to attempt to remove emotion from the negotiation and try to get the parties to cooperate with one another in order to resolve the dispute. *Id.*

30. *Id.*

31. Wrappe, *supra* note 2, at n.59. One of the reasons for mediation's success is the fact that it provides a number of benefits. First, since mediation only requires a mediator and a short period of time, it is generally considered the most flexible, time- and cost-effective ADR procedure available. Robert D. Adams & Donald F. Wood, *Mediation Under Announcement 95-2: IRS Proposes Dramatic Extension of Alternative Dispute Resolution*, 1/1/95 TAX EXECUTIVE, 1995 WL 8482657. Mediation generally results in a very high compliance rate on settlements and fewer disputes about implementing settlements because the parties themselves negotiate and agree to the settlements in an informal atmosphere. *Id.* Mediation provides an opportunity to deal with underlying issues in the dispute. Wrappe, *supra* note 2, at n.59. It facilitates mitigation of tensions between parties and builds understanding and trust, thereby avoiding the bitterness that may result from litigation. Further, it provides a basis by which parties negotiate their own dispute settlements in the future. *Id.* See also Louthan & Wrappe, *supra* note 3, at n.73; Alexei P. Mostovoi, *Tax Mediation: Is It Just a Test?*, 13 TAX NOTES INT'L 1871, 1872-73 (1996).

32. Wrappe, *supra* note 2.

determination of authority by the Tax Court became unnecessary because the IRS recently began to entertain the possibility of mediation of factual issues in tax disputes.³³ As a result, a detailed one-year test for mediation of tax disputes was established in Announcement 95-86.³⁴

III. ANNOUNCEMENT 95-86: MEDIATION IN TAX DISPUTES

A. Background

On January 9, 1995, the IRS published Announcement 95-2 which proposed a test of mediation procedures for Appeals.³⁵ The document contained a notice of a public hearing to be held on February 23, 1995, for testimony to be presented regarding suggestions and comments on the proposed program.³⁶ As a result of the comments³⁷ received concerning Announcement 95-2, the IRS issued Announcement 95-86 on October 13, 1995, which established a one-year test of mediation procedures for issues in the Appeals process effective October 30, 1995.³⁸

B. The Scope of Appeals Mediation Procedures

The purpose of the proposed mediation program is to attempt to resolve issues while a case is within Appeals' jurisdiction.³⁹ The program is intended for use only after Appeals settlement discussions fail and then is only appropriate for non-docketed, factual issues such as valuation, reasonable compensation and transfer pricing issues.⁴⁰

33. *Id.*

34. *Id.*

35. Announcement 95-2, 1995-2 I.R.B. 59.

36. *Id.*

37. As a result of comments made during the February 23, 1995 hearing, several changes were incorporated into the program. Those changes: (1) clarified that mediation was a non-binding process; (2) revised the disqualification provisions; (3) noted that the mediator should inform the parties of the rules and procedures pertaining to the mediation process; (4) clarified that mediation is not available for competent authority issues; (5) added a model agreement; (6) clarified that absent an agreement, the parties attending the mediation must have decision-making authority; (7) added that each party must send a participants list to the mediator two weeks prior to the mediation and added a model participants list; (8) added a model acknowledgment of disclosure of return and return information; (9) added a model mediator's report; and (10) added that the test for the program would be effective for one year following October 30, 1995. Announcement 95-86, *supra* note 9. Samples of some of these documents are available in Announcement 95-86.

38. *Id.*

39. *Id.*, Scope.

40. *Id.* In its original announcement, the IRS intended that the mediation procedures be available for non-docketed cases only; however, at the urging of Tax Court judges, the use of mediation was extended to include resolution of factual issues in docketed cases. The IRS recognizes that there is no specific Tax Court mechanism allowing for the use of mediation in docketed cases; however, support for mediation in docketed cases may be inferred under the court's general judicial authority in Tax Court Rule 1 or the broad language of Tax Court Rule 124. Louthan & Wrappe, *supra* note 3. The IRS has acknowledged the value of mediation in docketed cases; however, it cautions that mediation should not be used in lieu of established settlement procedures or when use of ADR procedures would unduly delay

A further limitation is that the procedure is available only for Coordinated Examination Program ("CEP")⁴¹ taxpayers with disputes assigned to Appeals Team Chiefs.⁴² This, in effect, imposes a limitation on the threshold dollar amount of issues that may be considered.⁴³

Finally, mediation will not be available for issues for which the taxpayer has sought, or intends to seek, competent authority assistance,⁴⁴ issues that are designated for an Industry Specialization Program ("ISP"),⁴⁵ or an Appeals Coordinated Issue ("ACI").⁴⁶

C. Requesting Appeals Mediation

Mediation is optional; therefore, provided the parties receive approval to mediate, either party may withdraw from the process.⁴⁷ Either party, the taxpayer or an Appeals Team Chief may request mediation after consultation with each other.⁴⁸ A written request seeking approval for mediation must be sent to the appropriate Assistant Regional Director of Appeals-Large Case ("ARDA-LC").⁴⁹ Generally the ARDA-LC responds within 30 days after receipt of the request and if the request is approved, then the parties are informed and a conference is scheduled.⁵⁰

discovery or trial. *Id.* See also Beehler, *supra* note 29; Mostovoi, *supra* note 31, at 1873-74.

41. Under the CEP, the IRS gives authority to a team of experienced revenue agents to audit complex returns of large corporate taxpayers. CEP taxpayer selection is based on a point system which takes into account several factors such as gross assets, the number of operating entities owned or controlled by the taxpayer, and the number of industries the taxpayer operates in. James C. Diana, *The New Mediation Procedure in Appeals: The Latest Development in the IRS' ADR Initiative*, 36 TAX MANAGEMENT MEMORANDUM 331 n.8 (1995).

42. *Id.* at 332; Announcement 95-86, *supra* note 9, Scope.

43. *Id.* Ordinarily only issues involving \$10 million or more will qualify according to this criteria. *Id.*

44. Competent authority assistance may be requested when a taxpayer believes that the actions of the United States, or a country which has a tax treaty with the United States, will lead to a tax result contrary to the terms of the applicable treaty. Acting through the Assistant Commissioner (International), the United States competent authority will attempt to reach a satisfactory agreement with the competent authority of the treaty partner. Diana, *supra* note 41, at 332 n.12.

45. ISP issues involve disputes that are peculiar to specific industries identified by the IRS and which the IRS attempts to provide coordinated and uniform treatment on a national level. *Id.* at n.17.

46. *Id.* at 332. ACI issues are a common set of facts involving a large number of taxpayers. The IRS attempts to provide uniform treatment by making a settlement offer available to all affected taxpayers. *Id.* at n.18.

47. Announcement 95-86, *supra* note 9, Mediation process §§ 1, 13. Either party may withdraw from the process any time prior to settlement by notifying the other party and the mediator in writing. *Id.*

48. *Id.*

49. *Id.* The ARDA-LC may request information about the issue to be mediated to determine if prior settlement discussions were truly unsuccessful, to help the ARDA-LC to determine how far apart the parties are in their analysis of the resolution of the issue, and to ascertain whether the issue is an appropriate factual issue for mediation. Louthan & Wrappe, *supra* note 3.

50. Announcement 95-86, *supra* note 9, Mediation process § 1.

If the request is denied because the taxpayer did not meet the required criteria,⁵¹ the parties are informed and the issues proceed through the normal Appeals process and on to litigation.⁵² Although no formal appeal procedure is available as to the ARDA-LC's decision, the taxpayer may request a conference to discuss the denial of the mediation request.⁵³

D. Agreement to Mediate and Pre-mediation Requirements

Upon approval by the ARDA-LC, the parties to the mediation must enter into a concise, written agreement to mediate.⁵⁴ The agreement should identify the participants,⁵⁵ the mediator or co-mediators,⁵⁶ the party who will bear the cost of the mediator,⁵⁷ the issues⁵⁸ to be mediated, the materials to be furnished to the mediator, and a proposed schedule and place for the mediation.⁵⁹

In addition, the taxpayer must acknowledge in writing that the mediator and all the participants in the mediation may have access to all of the taxpayer's tax returns or return information pertaining to the issues for mediation pursuant to I.R.C. § 6103.⁶⁰ Furthermore, all participants to the mediation shall not voluntarily disclose any information regarding the issues in mediation or the communications made during the mediation process except as provided in 5 U.S.C. § 574.⁶¹

51. See *supra* notes 41-48 and accompanying text.

52. *Id.*

53. *Id.*

54. Announcement 95-86, *supra* note 9, Mediation process § 2; see also Appendix.

55. The parties to the mediation are the taxpayer and Appeals. Absent any agreement to the contrary, the participants must have decision-making authority. Two weeks prior to the mediation session, each party must submit to each other and the mediator a participant's list identifying the mediation teams. *Id.*, Mediation process § 3; see also Appendix, Exhibit 2.

56. If the parties have not agreed on a mediator or co-mediators, then the procedure to be used in the selection of a mediator must be identified in the agreement. Announcement 95-86, *supra* note 9, Mediation process § 4; see also *infra* notes 66-69 and accompanying text.

57. See *infra* notes 70-72 and accompanying text.

58. Each party is to prepare a discussion summary of the issues for consideration by the mediator. This summary is to be submitted to the mediator and the other party two weeks prior to the date of the mediation session. Announcement 95-86, *supra* note 9, Mediation process § 8.

59. Because the agreement may be signed prior to the parties selecting a mediator, it is not expected that the agreement specify a definite time, date, and location for the mediation. Instead, the agreement should provide that the mediation session take place by a certain month, date, and year. Beehler, *supra* note 29.

60. Announcement 95-86, *supra* note 9, Mediation process § 10.

61. 5 U.S.C. § 574 (1996). Section 574 essentially provides that a party or a neutral in a dispute resolution proceeding shall not voluntarily disclose, or be required to disclose through discovery or compulsory process, any information concerning communications provided in confidence unless an agreement is otherwise made by the parties, the information is otherwise discoverable, or the information has already been made public. *Id.* See also Mostovoi, *supra* note 31, at 1875-78. In addition, the confidentiality requirement is superseded by I.R.C. § 7214(a)(8) which requires IRS employees to report information regarding violations of any revenue law to the Treasury Secretary. The mediation agreement will state this, and all parties are to acknowledge this duty. Announcement 95-86, *supra* note 9, Mediation process § 11.

E. Mediators: Selection and Disqualification

One of the most critical issues in the mediation process is the selection of a mediator. The mediator is chosen by the taxpayer and the ARDA-LC and must be mutually acceptable to all parties.⁶² Co-mediators may also be selected and may, in fact, be more desirous for the more complex issues.⁶³ The mediator or co-mediators should be named in the mediation agreement. Should the taxpayer and ARDA-LC not reach a mutual agreement, then they can agree on a procedure to be employed for selection of a mediator.⁶⁴

The mediator may be either an Appeals representative or a non-IRS employee.⁶⁵ If the mediator is from Appeals, that officer must be from another Appeals office or region, or from the National Office Appeals.⁶⁶ Due to the inherent conflict of interest present when using an Appeals officer as mediator, the IRS must include in the mediation agreement a "conflict statement" which discloses to the taxpayer that a conflict will exist because of that person's continued status as an IRS employee.⁶⁷ Furthermore, the statement will confirm the proposed duties the Appeals officer takes on as a mediator.⁶⁸

If an Appeals officer is chosen as the mediator or co-mediator, then the National Office Appeals will cover the expenses associated with that mediator.⁶⁹ Should an outside mediator⁷⁰ or co-mediator be chosen, the expenses incurred with regard to this mediator are to be split between the parties.⁷¹

The criteria for a mediator in the tax mediation program include mediation training, previous mediation experience, and substantive knowledge of tax law or

62. Announcement 95-86, *supra* note 9, Mediation process § 4.

63. *Id.*

64. *Id.*, Mediation process § 4.

65. *Id.*

66. *Id.*, Mediation process § 5.

67. *Id.*; *see also* Mostovoi, *supra* note 31, at 1879-80.

68. Announcement 95-86, *supra* note 9, Mediation process § 5.

69. *Id.* In addition to outside mediators, the IRS seeks to include mediations conducted by Appeals officers in the one-year test, hence the covered expenses incentive. Diana, *supra* note 41, at 334. To further this goal, a suggestion that co-mediators be used may prove beneficial if a taxpayer is reluctant to agree to the use of an Appeals officer as a mediator due to the inherent conflict of interest an Appeals employee may possess. These fears may be dispelled, however, by the use of an outside person as well as an Appeals officer as co-mediators. Co-mediators have the potential of increasing the chances of resolution through mediation while also providing a check on any tendency of the Appeals mediator to favor the position of the IRS. *Id.* at 334-35.

70. A mediator not affiliated with the IRS may be the most preferred in that he is bound by confidentiality and cannot disclose any information obtained through the mediation. Conversely, as discussed previously, all IRS employees are required by I.R.C. § 7214(a)(8) to disclose to the IRS any violation of revenue laws. This provision supersedes the mediation confidentiality provisions, thus, any violations disclosed during mediation may be reported by the IRS employees participating in the session be it as a mediator or a party. Beehler, *supra* note 29. To obtain an outside mediator, the taxpayer and the ARDA-LC may seek assistance from the Federal Mediation and Conciliation Service or the Administrative Conference of the United States. Announcement 95-86, *supra* note 9, Mediation process § 4.

71. Announcement 95-86, *supra* note 9, Mediation process § 6.

industry practices.⁷² Furthermore, projected travel expenses, hourly fees, and other costs will be taken into consideration.⁷³ The mediator must not have an undisclosed personal, official or financial conflict of interest with any of the parties.⁷⁴ If such a conflict exists, it must be fully disclosed in writing and submitted to all parties, and all parties must agree on the mediator with the disclosure taken into consideration.⁷⁵

The proposed mediation procedures provide for the disqualification of a mediator and his firm from (1) representing the taxpayer in any pending or future action related to the transactions or issues that are the subject matter of the mediation; (2) representing any other parties that are involved in the particular transactions or issues that are the subject matter of the mediation; and (3) representing the taxpayer or any other party involved in the mediation in any action involving the same taxable year as the object of the mediation.⁷⁶

The mediator and his firm are not precluded from future representation of the taxpayer in any other matter unrelated to the subject of the mediation before the Tax Court or any other forum.⁷⁷ Moreover, if the action involves a different tax year but the same transactions or issues of the mediation, the mediator's firm is not disqualified from representing the taxpayer in the matter so long as the mediator is screened from (1) participation in any action and (2) any direct allocation of fees related to the matter.⁷⁸ However, the mediator is not prohibited from receipt of a salary, partnership share or corporate distribution that is established by prior agreement.⁷⁹

F. Mediation and Settlement

Once the mediation is approved, a mediator is chosen, and all other pre-mediation procedures are completed, the mediation is ready to take place. Coming into the session, the mediator should have received summaries of the issues from both parties and have a basic understanding of each of their legal positions based on the facts presented. Generally the mediator begins the process by meeting with each party separately to discuss the strengths and weaknesses of their respective positions.⁸⁰ At some point, the mediator will have the two parties meet together to discuss possible resolutions to the dispute.⁸¹ The mediator brings to the process a new, unbiased analysis that is enhanced by negotiation expertise, prior experience and independent judgment that will enable him to fashion creative suggestions for

72. *Id.*, Mediation process § 7.

73. *Id.*

74. *Id.*, Mediation process § 4.

75. *Id.*

76. *Id.*, Mediation process § 12.

77. Beehler, *supra* note 29; Diana, *supra* note 41, at 335.

78. Announcement 95-86, *supra* note 9, Mediation process § 12.

79. *Id.*

80. F. Brook Anwyll et al., *Mediation in IRS Appeals -- An Innovative New Process*, 95 TAX NOTES INT'L 35-23 (1995).

81. *Id.*

settlement.⁸² Although the process is focused on the efforts of the parties to reach an agreeable settlement between themselves, the mediator provides a neutral buffer for the tension that may exist between the parties which could prevent them from reaching an agreement.

Once the mediation is complete, the mediator is required to file a written report briefly summarizing the results of the session.⁸³ This report is submitted to both parties to be reviewed and signed.⁸⁴ Those issues upon which the parties were able to reach an agreement through the mediation will be submitted to Appeals, because they retain jurisdiction over and have settlement authority with respect to cases submitted to mediation.⁸⁵ Appeals will use established procedures to finalize the agreement.⁸⁶

Appeals will not reconsider those issues upon which the parties do not reach an agreement,⁸⁷ those issues will be prepared for trial as normal.⁸⁸ Any issues that are not the subject of the mediation will remain in Appeals for consideration.⁸⁹

The settlement reached by the parties shall only apply to those parties. The proposed procedures provide that the settlement reached through mediation will not serve as an estoppel in any other proceeding.⁹⁰ Furthermore, it will not be considered or used as precedent in any other factually unrelated proceeding; therefore, any concessions made during the mediation will not prejudice a later proceeding.⁹¹ However, the resulting settlement of a nondocketed mediation may be used to resolve subsequent disputes in other tax years involving the same parties, pursuant to Delegation Order 236 (Rev. 2).⁹²

IV. POLICY CONSIDERATIONS

In Announcement 95-86, the IRS stated that the purpose of the test period is for Appeals to “resolve tax controversies, without litigation, on a basis which is fair and impartial to both the Government and the taxpayer.”⁹³ As this Comment discusses,

82. *Id.*

83. *Id.*, Mediation process § 14.

84. Announcement 95-86, *supra* note 9, Mediation process § 15.

85. *Id.*; see also Diana, *supra* note 41, at 335.

86. *Id.* These procedures may include preparation of a specific matter’s closing agreement – Form 906. *Id.* Also, Delegation Order 236, 1991-1 C.B. 313, (regarding rollover or recurring issues) may apply to settlements resulting from mediation procedures. *Id.* See also *supra* note 23 and accompanying text.

87. Appeals will not reconsider unresolved issues. Before entering the mediation process, the parties were to put forth efforts to resolve the dispute in Appeals and their efforts were unsuccessful. Diana, *supra* note 41, at 335.

88. Announcement 95-86, *supra* note 9, Mediation process § 15. See also Louthan & Wrappe, *supra* note 3.

89. Announcement 95-86, *supra* note 9, Mediation process § 15.

90. *Id.*, Mediation process § 16.

91. *Id.*

92. Louthan & Wrappe, *supra* note 3 at 1475. See also *supra* note 23.

93. Announcement 95-86, *supra* note 9, Overview.

the announcement prescribes several procedures and limitations that are to be followed when implementing the mediation program. When drafting the mediation process, the IRS looked very carefully at the possible consequences of the program.

Disputes arising within the tax system create issues distinct from those in typical commercial disputes. The government represents several contrary interests; therefore, its being a party has important ramifications. Aside from the primary interest and purpose the IRS has in collecting revenue, it also has an interest in obtaining retribution for tax misbehavior, and providing an example for the public.⁹⁴ In pursuing these interests, the IRS fulfills its obligation as a representative of the taxpayers, ensuring that they do not have to pay more than their fair share of the taxes collected. Since the government is financially supported by the taxpayers, it has an obligation to ensure that each taxpayer's monetary burden is not increased by others' nonpayment of taxes and frivolous utilization of government resources such as the court systems.⁹⁵ Hence, the IRS is forced to operate under an inherent conflict of goals: (1) fulfill its obligation to the taxpayers and raise the maximum revenue possible under the law, and (2) impartially resolve tax disputes.⁹⁶

Again, the heart of the United States tax system is the voluntary filing of tax assessments by individual taxpayers.⁹⁷ The level of cooperation with this requirement may be affected by taxpayers' perception of fairness within the system and comprehension of the law.⁹⁸ This reporting obligation operates without regard to taxpayers' perception or knowledge of the law.⁹⁹ Some procedural protection would be beneficial for the less knowledgeable taxpayer.

The IRS believes that mediation is a promising avenue for furthering its policies and interests. The benefits of mediation could prove it to be an effective means of resolution of taxpayer disputes that is less costly and time consuming. Furthermore, since no solution is imposed and withdrawal is available at any time for either party, mediation encourages the parties to understand each other's goals and reach a mutual agreement which will ultimately create a better relationship between the government and the taxpayer.

For the test period, the IRS placed several restrictions on the cases for which mediation would be made available. Some of its reasoning stems from an interest it has in promoting uniformity in resolution of certain issues such as ISP and ACI cases.¹⁰⁰ Furthermore, as mentioned, Appeals has an 85 to 90 percent success rate in its resolution of disputes and those cases not within this percentage oftentimes are the larger cases — the cases the program targets.¹⁰¹

Strict restrictions are placed on confidentiality among mediators and their firms. Successful mediation often depends upon the parties' willingness to release confidential information in the mediation session.¹⁰² The confidentiality

94. McDonough, *supra* note 10, at 40.

95. *Id.*

96. *Id.*

97. *Id.* at 38.

98. *Id.* at 40.

99. *Id.*

100. Diana, *supra* note 41, at 332.

101. Louthan & Wrappe, *supra* note 3.

102. Mostovoi, *supra* note 31, at 1875-76.

requirements encourage taxpayers to disclose information pertinent to settlement without the threat of an imposed solution, disclosure to the opposition should the mediation prove unsuccessful or disclosure of confidential information to the public.¹⁰³

Although the new tax mediation program has received widespread acceptance among critics, expansion of the scope of the program for the test period is greatly encouraged in order to provide a more meaningful test.¹⁰⁴ The most popular suggestions include expansion to legal as well as factual issues and availability to all taxpayers.¹⁰⁵ Although the IRS has taken these and other comments into consideration and recognizes their rationale, it has chosen to implement the original limitations for the trial period.

V. PROGRESS AND SUCCESS OF THE MEDIATION PROGRAM

Since implementation of the test period on October 30, 1995, the IRS Appeals division has been successful in its efforts to utilize mediation in settling taxpayer disputes. Within the test period, nine requests for mediation were made, four of which were approved. Two of these nine have been successfully mediated. The first tax dispute involved E. I. du Pont de Nemours ("DuPont").¹⁰⁶ The DuPont case was settled September 21, 1996, after only twelve hours of mediation. The entire process took three months.¹⁰⁷ DuPont requested mediation upon hearing about the program, and the case proved a good candidate for ADR because it involved a substantial amount of money and a factual issue.¹⁰⁸ This case involved the question of how the purchase price of a manufacturing facility would be allocated for tax purposes.¹⁰⁹ The parties chose to use two mediators for the session — a retired Tax Court chief judge and an appeals chief.¹¹⁰ Further details as to the issues and ultimate result are unavailable due to the confidentiality requirements of the program.¹¹¹

103. *Id.*

104. *See id.* at 1873-74; Fred Stokeld, *Tax Experts Urge Expansion of IRS Mediation Program*, 95 TAX NOTES INT'L 38-H (1995); Tax Executive Institute, *Announcement 95-2: Appeals Mediation*, 3/1/95 TAX EXECUTIVE, 1995 WL 8482675.

105. Although there may be more time pressures involved in docketed cases, the speed and flexibility of mediation may facilitate the resolution of disputes before litigation. Also, oftentimes disputes involve mixed questions of fact and law. Presently, these cases would be excluded. Allowing both legal and factual issues would open the doors to more taxpayers and obviate the need to differentiate between legal and factual issues. Finally, allowing mediation for large cases only -- \$10 million threshold amount in issue -- eliminates many cases that would greatly benefit from mediation. Cases not involving such high stakes may be easier to resolve through mediation and prove more cost effective to both the taxpayer and government. McDonough, *supra* note 10.

106. *Dupont Mediates Case Through IRS Program*, 14 ALTERNATIVES TO HIGH COST LITIG. 47.

107. *Id.*

108. *Id.*

109. *Id.*

110. *Id.*

111. *Id.*

A second case was successfully mediated at the beginning of 1997. Unfortunately the parties have chosen not to disclose any information regarding their mediation session and results.

The other two accepted cases are now pending and expected to reach an agreement soon.

Five of the nine requests were denied due to failure to meet the criteria set forth in Announcement 95-86.¹¹² Due to the seeming acceptance and interest in utilizing the mediation program, the IRS recently decided to expand the test period for another year. On January 13, 1997, the IRS released Announcement 97-1 extending the test of the mediation program set forth in Announcement 95-86 for an additional one-year period beginning January 13, 1997.¹¹³

With the release of Announcement 97-1, two other cases have been approved for the mediation program.

VI. CONCLUSION

The success of mediation in other forums foreshadows the success of mediation in the tax arena. Mediation provides a flexible alternative to litigation while enhancing the dispute resolution capabilities of the Appeals Division. By opening its doors to mediation of tax disputes, the IRS has taken a significant step toward its goal of implementing more efficient resolution procedures that advocate the preservation of amiable relationships with the taxpayers of the United States.

TONYA M. SCHERER

112. See Announcement 95-86, *supra* note 9. See also *supra* notes 39-46 and accompanying text.

113. Announcement 97-1, 1997-2 I.R.B. 22.

