Audit Reconsideration: An Effective, Low-Cost Means of Resolving Disputes with the IRS

By William P. Wiggins

William P. Wiggins discusses the audit reconsideration process, the procedures used to prepare an audit reconsideration request and briefly summarizes other techniques available for dealing with disputes with the IRS.

You receive a call from a woman who has just received a letter from the IRS. The letter makes reference to an examination of her 2005 tax return and informs her that she owes the government additional taxes along with interest and penalties. She tells you she is unaware of any examination of her 2005 tax return, so the letter makes no sense to her. After some discussion, you agree to meet with her to talk about her case.

A close reading of the letter reveals that it is a statutory notice of deficiency, or a so-called 90-day letter. The letter explains that if the taxpayer does not agree with the adjustments proposed in the enclosed examination report, the taxpayer is entitled to file a petition with the U.S. Tax Court within 90 days from the notice date (150 days if the notice is addressed to a person outside the United States).

You agree to accept this person as a client and help her resolve her dispute with the IRS. She asks you if "going to court" represents her only recourse at this point. Fortunately, you are able to tell her that going to court is one option, but several others exist, including (1) asking the IRS to reconsider her case (audit reconsideration); (2) asking the IRS to rescind the statutory notice of deficiency (the 90-day letter); (3) filing an Offer in Compromise with the IRS; (4) looking for deficiencies in the 90-day letter and claiming that it is defective; or (5) agreeing with the assessment and paying the deficiency. Your new client is interested in audit reconsideration and wants to know more about the process.

Part 1 of this article provides a detailed description and examination of the audit reconsideration process. Background information is explored and definitions are provided. The goals of audit reconsideration are presented and the reasons for using the reconsideration process are explained. Finally, the procedures used to prepare an audit reconsideration request are illustrated, including a sample report with illustrative language. Part 2 of the article discusses briefly some of the other techniques available for dealing with disputes with the IRS.

I. Audit Reconsideration

Background

While audit reconsideration has been an administrative process available to taxpayers and practitioners for many years, it has gain national attention in recent years. For example, in its 2001 report, the Treasury Inspector General for Tax Administration made the following observation:[1]

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> Audit reconsideration cases create an unnecessary burden on both the taxpayer and the Internal Revenue Service (IRS). In Fiscal Year (FY) 1999 alone, the IRS abated audit assessments on the accounts of approximately 106,000 individual taxpayers through its audit reconsideration process. This represents a burden on taxpayers because it requires them to address excessive tax assessments that should have been resolved during the initial audit. The IRS is also burdened by this rework because it must redirect its current compliance resources away from today's compliance issues.

Six years later, in her 2007 Annual Report to Congress ("2007 Report"), National Taxpayer Advocate Nina E. Olson ranked audit reconsiderations 19th out of the 26 most serious problems encountered by taxpayers today.[2] In support of this ranking, Olson noted that audit reconsiderations are "rework" and are costly to both the taxpayer and the IRS.[3] The 2007 Report lists the following reasons for the necessary rework:[4]

- IRS internal guidance that encourages early case closure but does not encourage solving the taxpayer's problem
- Use of the combination letter,[5] which shortens response time and may lead to incomplete examinations
- Lack of telephone contact to resolve issues, which may increase the likelihood of rework
- Lack of address searches beyond internal IRS data, which lessens the chance of establishing contact with the taxpayer

The 2007 Report also includes data about abatement rates relative to audit reconsiderations. These data are both informative and instructive for practitioners. For example, the Report notes that the IRS has acknowledged "high abatement rates for audit reconsideration requests, especially those originating from correspondence examinations and Automated Underreporter (AUR) notices" and that "the ratio of audit reconsiderations to the number of examinations is steadily increasing for correspondence examinations."[6]

Furthermore, the Report reveals that those taxpayers pursuing relief through the audit reconsideration process with the assistance of the Taxpayer Advocate Service have experienced a high success rate, as demonstrated in Table 1.

Table 1. Taxpayer Advocate Service (TAS) Audit Reconsideration Relief[1]

Fiscal Year	# of TAS Case Closures	% of Cases with Relief Granted	
		Full Relief	Partial Relief
2004	7,395	52.14%	9.09%
2005	7,276	56.93%	8.53%
2006	8,466	58.22%	8.85%
2007	11,091	71.07%	6.86%

[1] National Taxpayer Advocate 2007 Annual Report to Congress, Volume 1, December 31, 2007 at 289.

What do these national reports and associated data mean for taxpayers and their representatives? Although the reports include more data than could possibly be discussed within the scope of this article, three observations are pertinent for practitioners. First, the number of tax disputes resolved through the audit reconsideration process by the Taxpayer Advocate Service has grown rapidly in recent years, from 7,395 cases in 2004 to 11,091 cases in 2007.

Secondly, the rate of taxpayer success in finding relief through the audit reconsideration process is very high and continues to grow at a remarkable rate, from 52.14 percent (full relief) in 2004 to 71.07 percent (full relief) in 2007. While this high rate of success may be partially attributable to the support provided by the Taxpayer Advocate Service, it nonetheless informs practitioners that audit reconsideration is a highly effective and cost efficient option that should be seriously considered when handling tax disputes with the IRS. Finally, the reports tell us that many errors occur during the initial IRS examination process, thereby requiring a fair amount of rework after the fact. The reports also tell us that audit reconsideration serves as an excellent tool for conducting this rework of prior audits.

What Is Audit Reconsideration?

While there is no uniform definition of audit reconsideration, the following two definitions are commonly used:

> An Audit Reconsideration is the evaluation of a prior audit where additional tax was assessed and remains unpaid, or a situation when a taxpayer contests a 'substitute for return' determination by filing a delinquent return.[7]

> An Audit Reconsideration is the process the IRS uses to reevaluate the results of a prior audit where additional tax was assessed and remains unpaid, or a tax credit was reversed. If the taxpayer disagrees with the original determination, he/she must provide information that was not previously considered during the original examination. It is also the process the IRS uses when the taxpayer contests a Substitute for Return (SFR) determination by filing an original delinquent return.[8]

Although the Internal Revenue Code ("the Code") does not explicitly authorize the IRS to offer audit reconsideration as a relief provision to taxpayers, it does nonetheless authorize the IRS, in general terms, to abate the unpaid portion of the assessment of any tax or any liability in respect thereof, which (1) is excessive in amount, (2) is assessed after the expiration of the period of limitations, or (3) is erroneously or illegally assessed.[9]

In practical terms, this means the IRS has discretionary authority to evaluate a prior audit conducted by one of its employees. As discussed earlier, this evaluation represents a form of "rework" of a previous audit where some issues remain unresolved. In a typical audit reconsideration situation, the taxpayer believes that the prior audit resulted in an inappropriate increase in tax liability, and thus refuses to pay the additional tax. Often, the taxpayer was not present at the audit, either because the taxpayer was unaware of the audit (did not receive the notice) or simply decided not to respond to the notice. Regardless of the circumstances causing the dispute, there may be a need to evaluate the prior audit.

As demonstrated by the data presented earlier, audit reconsideration is a highly effective tool available to practitioners when evaluating the results of a prior audit. In addition to using audit reconsideration as a means to evaluate a prior audit, practitioners should consider using the reconsideration process in situations where clients have not filed tax returns, and the IRS has filed returns for them through the Substitute for Return (SFR) process. The SFR process allows the IRS to file tax returns on behalf of taxpayers in situations where taxpayers fail to make returns, or file (willfully or otherwise) a false or fraudulent return.[10] In these situations, Code Sec. 6020(b) authorizes the IRS to use information gathered through mandatory reporting processes (*e.g.*, Form 1099) as well as any other information available to the IRS. Significantly, Code Sec. 6020(b) states that any return prepared by the IRS shall be *prima facie* good and sufficient for all legal purposes.

In dissecting the definitions provided above, several important elements emerge when considering audit reconsideration as a tool for resolving disputes with the IRS. First, by its very nature, audit reconsideration presumes that some form of a prior audit was conducted (or, alternatively, the IRS filed a return for the taxpayer through the SFR process). Consequently, although perhaps obvious, audit reconsideration is not a tool available for use during an original IRS examination. Secondly, as an administrative process, audit reconsideration is discretionary. Thus, the IRS has the power to decide which cases it will approve for audit reconsideration. By comparison, the appeals function within the IRS is very different, as it guarantees taxpayers the right to have their cases heard by independent representative of the IRS. [11] Thirdly, the additional tax assessed by the IRS must remain unpaid; otherwise, the taxpayer will need to consider other options for seeking a refund.[12] Finally, the taxpayer must have something "new" to offer the IRS for consideration, which typically comes in the form of new evidence, *e.g.*, supporting documentation that was not previously considered by the examining agent.

What Are the Goals of the Audit Reconsideration Process?

The stated goals of the audit reconsideration process are as follows:[13]

- To ensure the amount of assessed tax is correct
- To ensure the collection process is suspended while the reconsideration request is being considered
- To ensure that procedures support the abatement of assessments in appropriate situations
- To ensure that cases are handled in a consistent manner

What lessons can we derive from these goals? First, we can infer that the IRS is willing to work with us to help resolve tax disputes in a cost-efficient, timely manner. Secondly, we can infer that the IRS is interested in ensuring that the amount of tax assessed is correct (no more, no less). Thirdly, we know that taxpayers benefit from having the tax collection process suspended while their requests are being considered by the IRS. Finally, we know that the goals support the notion of fairness and consistency on the part of the IRS when considering an audit reconsideration request.

What Are Some Reasons for Seeking Audit Reconsideration?

While there may be many reasons for seeking relief through the audit reconsideration process, some of the more common reasons include the following:[14]

- The taxpayer did not receive some or all of the correspondence mailed by the IRS to the taxpayer, *e.g.*, the taxpayer may have moved and the IRS does not have the taxpayer's current address.
- The taxpayer did not appear for an audit, *e.g.,* the taxpayer decided to ignore the notice.[15]
- The IRS did not consider some or all of the information submitted by the taxpayer in response to an inquiry by the IRS.
- The taxpayer disagrees with an assessment emanating from an earlier audit and now has new information relative to the dispute.
- The taxpayer disagrees with an assessment based on a return filed by the IRS through the SFR process.
- The taxpayer has been denied tax credits, such as EITC.

The following example illustrates one of the reasons listed above (the taxpayer disagrees with an assessment emanating from an earlier audit and now has new information relative to the dispute). In *Wong,*[16] the return of the taxpayers was audited by the IRS. Subsequently, the IRS mailed a notice of deficiency (90-day letter). The notice stated that as a result of the audit, an additional tax was being assessed. Additionally, the notice stated, in pertinent part, that (1) the taxpayers had 90 days from the date of the notice to file a petition with the U.S. Tax Court; (2) the Tax Court cannot consider a late petition; (3) the time to file a petition with the Tax Court cannot be extended or suspended; and (4) the receipt of other information or correspondence from the IRS will not change the period for filing a petition.

Upon receipt of the 90-day letter, the taxpayers, through their accountant, submitted a request for audit reconsideration based on new information they had relative to the audit. The IRS granted their request, stating in its letter that the taxpayers' case would be returned to the examination group for evaluation. At the bottom of the letter, the following handwritten statement appeared: "Time to file a petition [with the U.S. Tax Court] has expired." Nonetheless, the taxpayers filed a petition with the Tax Court. In response to the taxpayers' petition, the IRS filed a motion to dismiss for lack of jurisdiction on the ground that the petition was not timely filed. The Tax Court found that the taxpayers did not file their petition for redetermination with the Tax Court within the time prescribed by Code Secs. 6213(a) and 7502. Accordingly, the Court determined that it lack jurisdiction to re-determine the tax liability of the taxpayers and granted the IRS's motion to dismiss for lack of jurisdiction.

Even with this outcome, all hope was not lost. The taxpayers were still able to have their case reconsidered by the IRS through the audit reconsideration process. As noted by the Court, "The taxpayers did not begin to discuss audit reconsideration with the IRS until after the 90-day period had expired." There is a powerful message here for practitioners: given the discretionary nature of audit reconsideration (and the IRS's ability to use the process as it sees fit), the practitioner should always view audit reconsideration as a possible remedy for resolving a dispute with the IRS, even when more traditional vehicles are unavailable, such as filing a petition with the Tax Court.

Under What Circumstances Will the IRS View a Request for Audit Reconsideration Favorably?

The Internal Revenue Manual lists the following circumstances as examples of those situations in which it is likely to view a request favorably:[17]

- The taxpayer requests the abatement of an assessment based on information that was not previously considered which, if considered, would have resulted in a change to the assessment.
- An original delinquent return is filed by the taxpayer after an assessment was made as a result of a return executed by the IRS under Code Sec. 6020(b) or other substitute for return procedure.
- There was an IRS computational or processing error in assessing the tax.

Conversely, the IRS has indicated it will not consider a request for audit reconsideration in the following situations:[18]

- The taxpayer has already been afforded a reconsideration request and did not provide any additional information with his current request that would change the audit results.
- The assessment was made as a result of a closing agreement entered into under Code Sec. 7121, using Form 906, *Closing Agreements on Final Determination Covering Specific Matters,*

Form 866, *Agreement as to Final Determination of Tax Liability,* or some combination of the two forms.

- The assessment was made as a result of an offer in compromise under Code Sec. 7122, as these agreements are final and conclusive.
- The assessment was made as the result of final TEFRA administrative proceedings.
- The assessment was made as a result of the taxpayer entering into an agreement on Form 870-AD, *Offer of Waiver of Restrictions on Assessment and Collection of Deficiency in Tax.*
- The U.S. Tax Court has entered a decision that has become final, or a district court or the U.S. Court of Federal Claims has rendered a judgment on the merits that has become final.

At What Point in the Administrative Process Does Audit Reconsideration Become a Viable Tool for Resolving Tax Disputes?

Audit Reconsideration Based on a Prior Audit

The first point at which taxpayers usually seek relief through audit reconsideration is after a 90-day letter has been sent to them. As Table 2 illustrates, several administrative processes must occur before audit reconsideration becomes operative: (1) the IRS selects a return for examination (audit); (2) the audit concludes with an assessment that the taxpayer owes more taxes; (3) the taxpayer disagrees with the assessment; (4) the IRS sends a 30-day letter to the taxpayer; (5) the taxpayer does not respond to the 30-day letter; and (6) the IRS sends a 90-day letter. As shown in the table, upon receipt of the 90-day letter, several options exist for resolving the dispute, including audit reconsideration.

The next point at which audit reconsideration is commonly used is when the IRS begins the collection process (*see* Table 2). It is important to note here that the U.S. Tax Court must not have heard the case based on the merits; otherwise, audit reconsideration is unavailable. However, as illustrated in the earlier example, if the Tax Court heard a case but dismissed the case for lack of jurisdiction (*e.g.*, the time to file with the Court had expired), then audit reconsideration would continue to be available at the discretion of the IRS.

Table 2. Overview of IRS Administrative Processes and Opportunities To Use Audit Reconsideration as a Tool for Resolving Tax Disputes[1]

Administrative Processes	Taxpayer Options
1. IRS selects return for examination (audit)	• Do nothing and ignore audit • Self-representation at audit • Employ practitioner to represent taxpayer at audit
2. IRS audit concludes	• Agree with proposed adjustments and pay deficiency • Disagree with proposed adjustments and wait for the 30-day letter
3. IRS sends 30-day letter	• Do nothing and wait for the 90-day letter • Agree with proposed adjustments and pay deficiency • Protest the proposed adjustments (*e.g.*, prepare a formal written protest)[2]
4. IRS sends 90-day letter	• Do nothing and wait for the IRS to begin the collection process • Agree with proposed adjustments and pay deficiency • Request audit reconsideration • Request rescission of the notice of deficiency [Code Sec. 6212(d)] • File petition with the United States Tax Court
5. IRS initiates collection procedures	• Do nothing, with the possibility of wage garnishment, property seizure, etc. • Agree with proposed adjustments and pay deficiency • Request audit reconsideration • Initiate offer in compromise procedures • Initiate installment agreement procedures • Request Appeals hearing (Collection Due Process Appeal) • Pay deficiency and initiate refund suit in Federal District Court or the United States Court of Federal Claims

[1] The purpose of this figure is to illustrate the primary points at which audit reconsideration may be available. Thus, not all administrative processes or taxpayer options are included in the table.

[2] *See* William P. Wigigns, *The Art of Preparing a Successful Written Protest,* J. of Tax Practice & Procedure, April-May 2008, for more information regarding the preparation of a formal written protest.

Audit Reconsideration Based on the Substitution for Return (SFR) Procedures–Code Sec. 6020(b)

The IRS relies on Code Sec. 6020(b) for its authority to file tax returns for delinquent taxpayers as part of the SFR program. In part, the IRS uses the SFR program as a vehicle to identify and assess un-

reported tax liabilities, thereby forcing taxpayers back into compliance. Final regulations regarding Code Sec. 6020 were issued this year (February 2008). According to Reg. §301.6020-1(b)(1), the IRS may prepare tax returns based on information it has gathered through its various information reporting programs as well as from such information as the IRS can obtain through testimony or otherwise. The regulations at Reg. §301.6020-1(b)(5) provide the following example to illustrate the application of Code Sec. 6020(b):

Table 3. Taxpayer Advocate Service (TAS) Automated Substitute for Return (ASFR) Relief

Fiscal Year	# of TAS Case Closures	% of Cases with Relief Granted	
		Full Relief	Partial Relief
2004	4,697	54.82%	7.45%
2005	5,050	57.63%	6.61%
2006	5,588	57.53%	7.41%
2007	7,857	66.67%	5.46%

[1] National Taxpayer Advocate 2007 Annual Report to Congress, Volume 1, December 31, 2007, at 247.

Figure 1. Highlights of IRS Publication 3598

Purpose

- Audit reconsideration is an Internal Revenue Service procedure designed to help taxpayers when they disagree with the results of (1) an assessment the IRS made based on an examination (audit) of the taxpayer's return, or (2) a return prepared by the IRS (for the taxpayer) because the taxpayer did not file a return.
- The reconsideration process allows the IRS to reconsider a taxpayer's information informally. *The IRS resolves many cases at this level* [emphasis added].

Requirements

- The taxpayer must have filed a tax return, and:
  - Must include documentation that supports the taxpayer's position. It is recommended that the taxpayer include a copy of the examination report (Form 4549) along with any new documentation that supports the taxpayer's position.
  - Must write to inform the IRS of the changes the taxpayer wants the IRS to reconsider.
  - Must include a daytime and evening telephone number and the best time to call.

Next Steps

- The IRS will send a letter if it needs further information to reconsider the disputed issue(s).
- It is in the taxpayer's best interest to provide complete information on each disputed issue. The IRS considers each issue separately based on the new information that the taxpayer has provided. The IRS will change any adjustment if the new information and the tax law support the change.
- When the IRS receives the taxpayer's letter and documentation, it delays its collection activity. However, the IRS may resume collection activity if the documentation is not sufficient to support the taxpayer's position and the taxpayer does not respond to any request for additional information.
- If the taxpayer has an installment agreement, the taxpayer must continue to make payments.

Where to Send a Request for Audit Reconsideration

- To the address of the IRS Campus shown on the taxpayer's Examination Report. Note: Publication 3598 provides a complete list of campus centers along with the mailing address and phone numbers.

Conclusion of the Audit Reconsideration

- The IRS will notify the taxpayer once it completes its review to inform the taxpayer that:
  - It accepted the taxpayer's information. If so, the IRS will eliminate the tax assessed.
  - It accepted the taxpayer's information in part and will partially reduce the tax assessed.
  - The taxpayer's information did not support the taxpayer's claim and the IRS is unable to eliminate the tax assessed.

Figure 2. Basic Elements of a Request for Audit Reconsideration

Basic Elements	**Sample Language** (in summary format for illustrative purposes)
Introductory Information:	
Date of request	July 15, 2008
Address of appropriate Service Center to hear request	Internal Revenue Service Andover Campus P.O. Box 9053 Andover, MA 01810-0953
Taxpayer's name and address, a daytime telephone number, and taxpayer identification number	Re: Denise Bentley 3462 Forest Street Waltham, MA 02452 781-891-0000 TIN: 000-00-0000
Statement regarding relevant IRS correspondence	For example: 90-Day letter and attached documentation regarding proposed adjustments with respect to the above named taxpayer's income tax, penalty and interest liabilities for Form 1040, year ended December 31, 2005.
Statement that the taxpayer is requesting an audit reconsideration	This letter is to request an Audit Reconsideration for Ms. Denise Bentley for the 2005 tax year regarding the denial of certain deductions associated with her real estate development business.
The tax periods or years involved	December 31, 2005 (Form 1040)
Issue(s) to be address:	Issue #1: Whether the taxpayer is entitled to a business expense deduction under §162 and §274(a)(1)(A) of the IRC for the 2005 tax year for a party she hosted for business associates. Issue #2: Whether a proposed imposition of a substantial underpayment penalty pursuant to IRC §6662(a) is appropriate under the circumstances.
Law: Provide a statement of the law on which the taxpayer is relying *Note:* Because this Figure is for illustrative purposes, a brief statement of the law is provided for the first issue only.	Generally, business expenses are deductible if they are shown to be "ordinary and necessary." *See* Code Sec. 162. Business entertainment expenses are deductible, however, only if they are shown to be "ordinary and necessary" and (1) that the expenditure was directly related to the active conduct of the taxpayer's trade or business, or (2) in the case of an expenditure directly preceding or following a substantial and bona fide business discussion (including business meetings at a convention or otherwise), that the expenditure was associated with the active conduct of the taxpayer's trade or business. *See* Code Sec. 274(a)(1)(A); Reg. §1.274-2(a)(1).
Facts: Provide a detailed statement of the facts on which the taxpayer relies. This statement must establish clearly why the taxpayer is entitled to relief through the audit reconsideration process. *Note:* Because this Figure is for illustrative purposes, a brief statement of the facts is provided for the first issue only.	In 2008, the IRS requested documentation related to a deduction the taxpayer claimed on her 2005 tax return for an annual party she held for business associates in 2005. The taxpayer failed to respond to this request as well as to subsequent requests from the IRS. Her non-responsiveness was a result of her son experiencing a serious medical ailment at the time of the requests. In its most recent correspondence with the taxpayer, the IRS proposed changes to her 2005 return, including the disallowance of a deduction in the amount of $25,329 for expenses associated with her annual party for business associates. For a number of years, the taxpayer has hosted an annual party in July for business associates, the vast majority of whom are local real estate agents. The official program of the party includes (1) a welcoming hour, (2) a buffet dinner, and (3) live entertainment by a well-known local symphony. During the welcoming hour, the taxpayer addresses the attendees and thanks them for their dedication and efforts to sell houses associated with her real estate development business. On her annual tax returns, the taxpayer has consistently deducted the costs associated with these annual parties as business-related entertainment expenses pursuant to Code Secs. 162 and 274.

Argument: Provide an analysis of the facts and the law that supports the taxpayer's position. *Note:* Because this Figure is for illustrative purposes, a brief analysis is provided for the first issue only.	On her 2005 tax return (Form 1040), the taxpayer was denied a business deduction for a regular party she holds each year for business associates relative to her real estate development business. The taxpayer should have been allowed the deduction for this business expense because she has satisfied the requirements of Code Sec. 162 and Code Sec. 274 in two ways. First, through the attached affidavits, the taxpayer has established that the attendees at the 2005 party would have reasonably known that the taxpayer had no significant motive, in incurring the expenditure, other than directly furthering her trade or business. See Reg. §1.274-2(c)(4). Secondly, through the attached documentation, including a description of the venue used for the party (a local hotel), the formal program brochure for the annual party, and the formal invitations sent to the attendees, the taxpayer has clearly established that the 2005 annual party was entertainment of a clear business nature under circumstances where there was no meaningful personal or social relationship between the taxpayer and the recipients of the entertainment. See Reg. §1.274-2(c)(4). In support of the taxpayer's request for audit reconsideration, the following exhibits are attached.
Exhibits: Provide copies of the documentation that supports the taxpayer's position.	Exhibit 1: Form 2848 (Power of Attorney) Exhibit 2: Sworn affidavit of Mr. John Smith, real estate agent Exhibit 3: Sworn affidavit of Ms. Lisa Green, real estate agent Exhibit 4: Sworn affidavit of Ms. Melissa Brown, real estate agent Exhibit 5: Copy of the 2005 party program brochure Exhibit 6: Copy of the 2005 party invitation sent to attendees Exhibit 7: Copy of the brochure describing the venue for the 2005 party
Conclusion:	The enclosed documents along with relevant statements of law, facts, and augments establish that the taxpayer is entitled to the business expense deduction that she claimed on her 2005 tax return for the regular annual party she holds each year for business associates. Accordingly, the taxpayer's request for audit reconsideration should be granted. Please contact me at 781-891-1234 if you have any questions. Sincerely, William P. Wiggins, Esq.

Example 1. Individual A, a calendar-year taxpayer, fails to file his 2003 return. Employee X, an IRS employee, opens an examination related to A's 2003 tax year. At the end of the examination, X completes a Form 13496, *Code Sec. 6020(b) Certification,* and attaches to it the documents listed on the form. Those documents explain examination changes and provide sufficient information to compute A's tax liability. The Form 13496 provides that the IRS employee identified on the form certifies that the attached pages constitute a return under Code Sec. 6020(b). When X signs the certification package, the package constitutes a return under paragraph (b) of this section because the package identifies A by name, contains A's taxpayer identifying number (TIN), has sufficient information to compute A's tax liability and contains a statement stating that it constitutes a return under Code Sec. 6020(b). In addition, the IRS will determine the amount of the additions to tax under Code Sec. 6651(a)(2) by treating the Code Sec. 6020(b) return as the return filed by the taxpayer. Likewise, the IRS will determine the amount of any addition to tax under Code Sec. 6651(a)(3), which arises only after notice and demand for payment, by treating the Code Sec. 6020(b) return as the return filed by the taxpayer.

Beyond the goal of bringing taxpayers back into compliance, why does the IRS use the SFR process to prepare returns for delinquent taxpayers? It's simple: The government loses billions of dollars every year because taxpayers do not timely file tax returns and pay associated tax liabilities. For example, Taxpayer Advocate Nina E. Olson reports that "an estimated $25 billion of the tax year 2001 gross tax gap is attributable to individuals who do not timely file tax returns."[19]

How does Audit Reconsideration come into play? Unfortunately, the SFR procedures are not very

effective in calculating the correct tax liability of those taxpayers for whom a substitute return is filed. Consequently, many of the returns generated through the SFR process are incomplete and/or inaccurate, thereby necessitating the need to take a fresh look at the return (audit reconsideration).

Why are there so many problems associated with returns filed through the SFR system? While there may be many reasons for the problems, some of the more common ones include the following:[20]

- Taxpayers often receive notices without any human involvement to evaluate whether an assessment is reasonable.
- Taxpayers receive notices in which their incomes as reported to the IRS had more than doubled because erroneous Forms 1099 were issued in their names.

Figure 3. Essential Elements of Rev. Proc. 98-54 Rescission of a Notice of Deficiency

If a notice of deficiency is rescinded, it is generally treated as if it never existed
A rescinded notice suspends the running of the period of limitations under §6503 for the period during which the notice is outstanding
The taxpayer may exercise all administrative and statutory appeal rights from a reissued notice of deficiency, but cannot petition the Tax Court from a rescinded notice of deficiency
A notice of deficiency may be rescinded for the following reasons: • The notice was issued as a result of an administrative error; *e.g.,* the notice was issued (1) to the wrong taxpayer, (2) for the wrong tax period, or (3) without considering a properly executed Form 872, Consent to Extend the Time to Assess Tax, or Form 872-A • The taxpayer submits information establishing the actual tax due is less than the amount shown in the notice • The taxpayer specifically requests a conference with the appropriate Appeals office for the purpose of entering into settlement negotiations. However, the notice may be rescinded only if the appropriate Appeals office first decides that the case is susceptible to agreement
The IRS will not rescind a notice of deficiency under the following circumstances: • On the date of the rescission, 90 days or less would remain before the expiration date of the period of limitations on assessment • The 90-day or 150-day restriction period under Code Sec. 6213(a) has expired without the taxpayer filing a petition with the Tax Court • The taxpayer has filed a petition with the Tax Court • The taxpayer and the IRS, prior to the issuance of the notice of deficiency, have executed a Form 872-A covering any of the tax years in the notice of deficiency
Taxpayers who wish to have a notice of deficiency rescinded should contact the person/office listed on the notice and request Form 8626
Taxpayers who wish an Appeals conference should contact the person/office listed on the notice to find out how to contact the appropriate Appeals Office
A request to rescind a notice of deficiency should be made by the taxpayer as soon as possible after receipt of the notice
If the IRS determines that a notice of deficiency should be rescinded, the IRS will send Form 8626 to the taxpayer requesting the taxpayer's written consent to rescind
If appropriate, Form 872 or Form 872-A will also be sent for the taxpayer's signature. If the taxpayer agrees to the rescission of the notice of deficiency, the signed Form 8626 (and Form 872 or Form 872-A if appropriate) must be returned to the office that sent the Form 8626 as soon as possible, prior to the expiration of the applicable 90-day or 150-day restriction period
A properly executed Form 8626 (or a document as provided in section 5.06 of this revenue procedure) is the only way that a notice of deficiency may be rescinded
If the IRS does not agree that the notice of deficiency should be rescinded, the taxpayer will be so notified in writing, and the notice of deficiency will remain in effect. If the taxpayer wishes to file a petition with the Tax Court, the taxpayer must file the petition within the applicable 90-day or 150-day restriction period, which may not be extended

- A simple human review would have allowed these taxpayers to avoid the significant burden of rectifying these errors (often through the audit reconsideration process).

As demonstrated by the data shown in Table 3, there are significant opportunities available for practitioners to work with the IRS (often through the audit reconsideration process) to cure problems found in SFR generated returns. The table shows a remarkably high rate of success in securing "full relief" for taxpayers.

How Do I Prepare a Request for Audit Reconsideration?

The stated criteria for determining when the IRS will consider granting a taxpayer's request for audit reconsideration follow:[21]

- The taxpayer must have filed a tax return.
- The assessment remains unpaid or the IRS has reversed tax credits that the taxpayer is disputing.
- The taxpayer must know which adjustments are being disputed.
- The taxpayer must provide additional information not considered during the original examination.

As mentioned earlier, audit reconsideration is an informal, discretionary process offered by the IRS. Although the IRS affords taxpayers the opportunity to make a request for audit reconsideration, it provides minimal guidance about how to make such a request.[22] Furthermore, unlike many other IRS procedures, the IRS does not require the completion of a particular form when making the request. The limited guidance

Figure 4. Essential Elements of Rev. Proc. 2003-71 Offer in Compromise

An offer to compromise a tax liability must be submitted in writing on Form 656, *Offer in Compromise*
None of the standard terms may be stricken or altered, and the form must be signed under penalty of perjury
The offer must include all liabilities to be covered by the compromise, the legal grounds for compromise, the amount the taxpayer proposes to pay and the payment terms
An offer to compromise a tax liability should set forth the legal grounds for compromise and should provide enough information for the IRS to determine whether the offer fits within its acceptance policies, including an analysis of "doubt as to liability" and "doubt as to collectability"
Doubt as to liability exists where there is a genuine dispute as to the existence or amount of the correct tax liability: • Doubt as to liability does not exist where the liability has been established by a final court decision or judgment concerning the existence of the liability • An offer to compromise based on doubt as to liability generally will be considered acceptable if it reasonably reflects the amount the government would expect to collect through litigation • The analysis should include consideration of the hazards of litigation that would be involved if the liability were litigated. The evaluation of the hazards of litigation is not an exact science and is within the discretion of the IRS
Doubt as to collectability exists in any case where the taxpayer's assets and income cannot satisfy the full amount of the liability: • An offer to compromise based on doubt as to collectability generally will be considered acceptable if it is unlikely that the tax can be collected in full and the offer reasonably reflects the amount the IRS could collect through other means, including administrative and judicial collection remedies • This amount is the reasonable collection potential of a case. In determining the reasonable collection potential of a case, the IRS will take into account the taxpayer's reasonable basic living expenses • In some cases, the IRS may accept an offer of less than the total reasonable collection potential of a case if there are special circumstances

provided by the IRS can be found in IRS Publication 3598, highlights of which are presented in Figure 1. Figure 2 presents the basic elements of a request for audit reconsideration along with sample language. Given the scope of this article, the language is necessarily presented in an abbreviated form.

II. Other Techniques Available for Dealing with Disputes with the IRS

Introduction

While audit reconsideration is an effective, low-cost means of resolving disputes with the IRS, other vehicles are available to the practitioner. Some of the more common techniques include the following:

- Rescind the deficiency notice (90-day letter) under the authority of Code Sec. 6212(d).
- File an offer in compromise.
- Pursue the controversy in court.
- Claim that the 90-day letter is defective.
- Agree with the proposed adjustments and pay the deficiency.

Two of these options are discussed briefly in this part of the article: (1) rescission of the notice of deficiency; and (2) filing an offer in compromise.

Rescission of the Deficiency Notice (90-Day Letter)

Code Sec. 6212(d) provides the taxpayer and the IRS with a statutory vehicle for "stopping the clock" on the running of a 90-day letter.[23] In other words, it affords both parties the opportunity to resolve the dispute at the administrative level, rather than forcing the taxpayer to petition the Tax Court and incur the high cost of litigation. Obviously, both the taxpayer and the IRS have an interest in resolv-

ing the dispute administratively; it saves time and money for both parties.

Code Sec. 6212(d) provides in part that the IRS may, with the consent of the taxpayer, rescind any notice of deficiency mailed to the taxpayer. Any notice so rescinded shall not be treated as a notice of deficiency, and the taxpayer shall have no right to file a petition with the Tax Court based on such notice. For guidance on how to execute an agreement with the IRS pursuant to Code Sec. 6212(d), the practitioner should consult Rev. Proc. 98-54, the essential elements of which are presented in Figure 3.[24]

File an Offer in Compromise

The government, like other creditors, may encounter situations in which it is unlikely that an outstanding receivable will be paid in full.[25] In these sections, Code Sec. 7122(a) authorizes the IRS to negotiate with the taxpayer to reduce the taxpayer's financial obligation. Like other kinds of agreements between a debtor and a creditor, an offer in compromise takes the form of a contractual agreement between the IRS and the taxpayer.[26]

The IRS accepts an offer in compromise from a taxpayer when it is unlikely that the tax liability can be collected in full and the amount offered reasonably reflects the collection potential.[27] Taxpayers are responsible for initiating a proposal for compromise, and the success of the offer is assured only if taxpayers make adequate compromise proposals consistent with their ability to pay the government.[28] Taxpayers are expected to provide reasonable documentation to verify their ability to pay and offers will not be accepted if it is believed that the liability can be paid in full as a lump sum or through installment payments extending through the remaining statutory period for collection.[29]

Rev. Proc. 2003-71 explains the procedures applicable to the submission and processing of an offer in compromise, the essential elements of which are presented in Figure 4.[30]

Conclusion

Despite the anxiety many taxpayers often experience when they receive notices and other forms of correspondence from the IRS, many options exist for working with the IRS to resolve taxpayer disputes. The options are often informal in nature and discretionary on the part of the IRS. Contrary to popular belief, the IRS is usually as interested as the taxpayer in resolving disputes in an efficient, cost-effective way. As demonstrated in this article, Audit Reconsideration is a highly effective, low-cost means of resolving disputes with the IRS. Practitioners would be wise to consider Audit Reconsideration as one of several options available when working with the IRS to resolve tax disputes on behalf of their clients.

Endnotes

1 Treasury Inspector General for Tax Administration, *Audit Reconsideration Cases Create Unnecessary Burden on Taxpayers and the Internal Revenue Service,* March 2001, at i, Reference No. 2001-40-053.

2 1 National Taxpayer Advocate 2007 Annual Report to Congress, Dec. 31, 2007, at xi.

3 *Id.*, at 287.

4 *Id.*, at 287.

5 The so-called combination letter was created by the IRS in 1998. Its intended purpose was to reduce the cycle time of correspondence examinations. Essentially, the letter combined two existing IRS documents (the initial contact letter and the official examination report) into one correspondence document. For more information about the effectiveness of the combination letter, *see* National Taxpayer Advocate 2003 Annual Report to Congress, at 87–98, National Taxpayer Advocate 2006 Annual Report to Congress, at 296–97, and 1 National Taxpayer Advocate 2007 Annual Report to Congress, Dec. 31, 2007, at 292.

6 1 National Taxpayer Advocate 2007 Annual Report to Congress, Dec. 31, 2007, at 289.

7 *Id.*, at 287.

8 IRM 4.13.1.2 (Oct. 1, 2006).

9 Code Sec. 6404(a); Reg. §301.6404-1.

10 Code Sec. 6020(b)(1).

11 *See* William P. Wigigns, *The Art of Preparing a Successful Written Protest,* J. Tax Practice & Procedure, Apr.–May 2008, for an overview of the IRS Appeals process.

12 For example, filing a refund suit in federal district court or the U.S. Court of Federal Claims.

13 IRM 4.13.1.1 (Oct. 1, 2006).

14 IRM 4.13.1.3 (Oct. 1, 2006).

15 For more information about the reasons why taxpayers may not understand correspondence mailed by the IRS or why they do not respond to IRS inquiries, *see* National Taxpayer Advocate 2004 Annual Report to Congress, at 355–75.

16 *E.K. Wong*, 79 TCM 1652, Dec. 53,798(M), TC Memo. 2000-88.

17 IRM 4.13.1.7 (Oct. 1, 2006).

18 IRM 4.13.1.8 (Oct. 1, 2006).

19 1 National Taxpayer Advocate 2007 Annual Report to Congress, Dec. 31, 2007, at 242.

20 *Id.*

21 IRM 4.13.1.4 (Oct. 1, 2006).

22 *See* IRS Publication 3598, *What You Should Know about the Audit Reconsideration Process* (Rev. 11-2005).

23 The 90-day period provided in the notice of deficiency extends to 150 days if it is addressed to taxpayers residing outside the Untied States (Code Sec. 6213(a)).

24 Rev. Proc. 98-54, 1998-2 CB 531.

25 IRM 5.8.1.1 (Sept. 1, 2005).

ENDNOTES

[26] IRM 5.8.1.1.1 (Sept. 1, 2005).
[27] IRM 5.8.1.1.3 (Sept. 1, 2005).
[28] *Id.*
[29] *Id.*
[30] Rev. Proc. 2003-71, IRB 2003-36.