

## **Alert** | Tax Controversy and Litigation



February 2025

### **IRS Finalizes Treasury Regulations for Taxpayers Seeking Appeals Consideration**

#### **Go-To Guide**

- The Internal Revenue Service (IRS or the Service) has released final regulations outlining when taxpayers may seek consideration from the IRS Independent Office of Appeals (Appeals) for “Federal tax controversies,” as defined below.
- The final regulations clarify the statutory language of I.R.C. section 7803(e)(4), which states that the Appeals resolution process is “generally available to all taxpayers,” by providing 24 specific exceptions to Appeals consideration.
- When denying Appeals consideration for taxpayers who received a notice of deficiency, the IRS must provide the taxpayer with a detailed explanation of the reason for the denial and allow the taxpayer to protest such denial, provided the relevant regulatory requirements have been met.

On Jan. 15, 2025, the IRS finalized proposed regulations implemented under I.R.C. section 7803(e) that provide guidance on the resolution of Federal tax controversies by Appeals. The final regulations clarify the statutory language of I.R.C. section 7803(e)(4), which states that the Appeals resolution process is “generally available to all taxpayers,” by providing specific exceptions to Appeals consideration. The final regulations also define what constitutes a “Federal tax controversy” and provide procedural and timing rules that must be met before Appeals consideration is available.

This GT Alert does not discuss every exception, nor does it provide the underlying rationale for the exceptions or the thought process behind the final regulations. For a full discussion, please see Resolution of Federal Tax Controversies by the Independent Office of Appeals, 90 Fed. Reg. 3,645 (Jan. 15, 2025) (to be codified at 26 C.F.R. pt. 301).

These regulations took effect Jan. 15, 2025. Treas. Reg. sections 301.7803-2 and 301.7803-3 apply to all requests for Appeals consideration received after Feb. 14, 2025.

### **‘Federal Tax Controversy’ Defined**

While I.R.C. section 7803(e)(3) provides that Appeals’ function is to “resolve Federal tax controversies without litigation,” it does not define what constitutes a “Federal tax controversy.” Under Treas. Reg. section 301.7803-2(b)(2), a Federal tax controversy is:

...a dispute over an administrative determination with respect to a particular taxpayer made by the IRS in administering or enforcing the internal revenue laws, related Federal tax statutes, and tax conventions to which the United States is a party (collectively referred to as internal revenue laws) that arises out of the examination, collection, or execution of other activities concerning the amount or legality of the taxpayer’s income, employment, excise, or estate and gift tax liability; a penalty; or an addition to tax under the internal revenue laws.

Examples of Federal tax controversies include disputes over an IRS administrative determination concerning a taxpayer’s proposed deficiency, a taxpayer’s claim for credit or refund, or the tax-exempt nature of a particular organization, private foundation, or qualified employee plan.

Treas. Reg. section 301.7803-2(b)(3) provides that certain administrative decisions will still be treated as Federal tax controversies, notwithstanding the definition above. These include, for example, liabilities and penalties administered by the IRS outside of the Internal Revenue Code (e.g., FBAR penalties) or requests under the Freedom of Information Act.

### **Key Exceptions to Appeals Consideration**

Treas. Reg. section 301.7803-2(c)(1)-(24) provides 24 Federal tax controversies specifically excepted from Appeals consideration. Some of these exceptions are discussed below and are referred to by their place within Treas. Reg. section 301.7803-2(c) (e.g., Treas. Reg. section 301.7803-2(c)(**10**) is referred to as “Exception **10**”).

#### *Exceptions 1 and 2 – Frivolous Positions and Resulting Penalties*

Exceptions 1 and 2 provide that Appeals will not consider cases where the Service has made an administrative determination rejecting a taxpayer’s position as frivolous or where the IRS has assessed a penalty for asserting a frivolous position, making a frivolous submission, or providing false information.

#### *Exception 10 – Taxpayers With Pending Criminal Cases*

Under Exception 10, Appeals consideration is unavailable while a criminal prosecution or recommendation for criminal prosecution is pending against a taxpayer for a tax-related offense, other than with the concurrence of IRS Chief Counsel and the Justice Department, as applicable. This applies to any tax-related offenses for which a criminal prosecution (or recommended criminal prosecution) is pending and not only those that involve common facts or tax transactions.

### *Exception 12 – Certifications or Issuances of Seriously Delinquent Tax Debt*

Where a taxpayer has a “seriously delinquent tax debt,” the Service will transmit a certification of the tax debt to the State Department to deny, revoke, or otherwise limit the taxpayer’s passport pursuant to I.R.C. section 7345. Under Exception 12, these certifications are not subject to Appeals consideration.

### *Exception 18 – Challenges Alleging a Statute is Unconstitutional*

Appeals consideration is not available for any issue based on a taxpayer’s argument that a statute violates the U.S. Constitution, unless there is an unreviewable decision from a federal court holding that the cited statute is unconstitutional. An “unreviewable decision” is a decision of any federal court, regardless of where the taxpayer resides, that can no longer be appealed to any federal court because all appeals in a case have been exhausted or the time to appeal has expired and no appeal was filed.

### *Exceptions 19 and 20 – Taxpayer Arguments Concerning ‘Invalid’ Treasury Regulations, IRS Notices, or Revenue Procedures*

Exceptions 19 and 20 specifically preclude Appeals consideration based on a taxpayer’s argument that a Treasury Regulation, an IRS Notice, or a Revenue Procedure published in the Internal Revenue Bulletin is invalid, unless there is an unreviewable decision from a federal court invalidating the regulation, notice, or procedure. Exceptions 19 and 20 do not preclude arguments other than the validity of a Treasury Regulation, IRS Notice, or Revenue Procedure, such as whether they apply to the taxpayer’s facts and circumstances.

Like Exception 18, the final regulations for Exceptions 19 and 20 do not require that the “unreviewable decision” be in the same judicial circuit as where the taxpayer resides.

### *Exception 21 – Cases or Issues Designated for Litigation or Withheld from Appeals*

Exception 21 provides that Appeals consideration is not available for any case or issue designated for litigation or withheld from Appeals consideration in a Tax Court case. “Designated for litigation” means that the issue or issues in a case will not be resolved without a full concession by the taxpayer or by a decision of the court. Cases are designated for litigation by the Office of Chief Counsel or withheld in the interest of sound tax administration to establish judicial precedent, promote consistency, conserve resources, or reduce litigation costs for taxpayers and the Service.

## **Procedural and Timing Requirements**

Treas. Reg. section 301.7803–2(e) states that taxpayers must submit a request for Appeals consideration in the time and manner prescribed and meet all procedural requirements for Appeals to consider a Federal tax controversy. In addition, there must be sufficient time remaining on the statutory limitations period. If a case is docketed in the U.S. Tax Court, if the Office of Chief Counsel has recalled the case from Appeals, or if Appeals has returned the case to the Office of Chief Counsel, further Appeals consideration will be unavailable if there is insufficient time for consideration.

## **One Opportunity for Appeals Consideration**

Pursuant to Treas. Reg. section 301.7803-2(f)(1), if a Federal tax controversy is eligible for Appeals consideration and the requirements have been met, a taxpayer generally has one opportunity for Appeals consideration.

If there is insufficient time remaining on the limitations period for Appeals consideration, a taxpayer in receipt of a notice of deficiency can seek Appeals consideration after a petition has been filed with the Tax Court and the case is docketed, assuming the issue is not subject to an exception described in the final regulations.

### **Contesting a Denial of Appeals Consideration**

I.R.C. section 7803(e)(5) requires the Service to follow special notification procedures if a taxpayer who has received a notice of deficiency requests referral of the Federal tax controversy to Appeals and that request is denied. The IRS must provide the taxpayer with a detailed description of the basis for the denial and allow the taxpayer to protest the denial, provided that the taxpayer meets certain requirements under Treas. Reg. section 301.7803-3(a).

In addition to the notice of deficiency, Treas. Reg. section 7803-3(a)(2)-(5) further requires that the issue may not be a frivolous position (consistent with Exceptions 1 and 2), cannot be for a matter for which the taxpayer has already sought (or received) Appeals consideration, and must include all matters or issues in the notice of deficiency.

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