



### IRS Updates Procedures for Appeals Mediation Program

The Internal Revenue Service's Appeals mediation program provides taxpayers who are unable to resolve issues during the traditional Appeals settlement process with another opportunity to resolve those issues before litigation. There are no strings attached to the Appeals mediation process – either party may walk away from the mediation at any time, and the recommendations of the mediator, or co-mediators, are not binding on the parties. Due to the rapid pace of Appeals mediation and the fact that all factual and legal issues typically have been developed during the Appeals settlement process, Appeals mediation involves minimal additional costs and time for taxpayers who are otherwise destined for litigation. Consequently, mediation is a valuable opportunity for most taxpayers, although in our experience, relatively few taxpayers have taken advantage of the Appeals mediation program. By publishing Revenue Procedure 2009-44, the Internal Revenue Service (the “Service”) once again is promoting the mediation program, and taxpayers with current controversies should take notice.

#### Introduction

As most taxpayers are well aware, the Service maintains an Appeals Division (“Appeals”) to resolve controversies arising during the examination process. A taxpayer can protest proposed Examination Division adjustments, and an Appeals officer will suggest a resolution. The taxpayer may not be inclined to accept the Appeals offer, but prior to the issuance of Revenue Procedure 2002-44, the taxpayer may not have had any other options for resolving the controversy short of litigation. In Revenue Procedure 2002-44, the Service outlined the framework for the Appeals mediation program. Now the Service has issued Revenue Procedure 2009-44, updating the procedures for the Appeals mediation program and further promoting the Appeals mediation program. Revenue Procedure 2009-44 provides new opportunities for taxpayers to take advantage of Appeals mediation by expanding the scope of the program and clarifying a few technical issues. Many taxpayers are unaware of the benefits of the Appeals mediation program and overlook it. As discussed below, Appeals mediation is an option that all taxpayers with unresolved issues should consider, because the process is less expensive than litigation, relatively fast, and offers taxpayers a second chance to settle their issues without requiring any binding commitment. Furthermore, taxpayers who have unresolved factual issues following Appeals mediation should consider whether the Appeals arbitration program may yield a better outcome for the taxpayer than litigation.

#### Overview of the Appeals Mediation Process

The Appeals mediation program provides a formal process for taxpayers to request mediation for qualifying issues within the jurisdiction of Appeals. If negotiations during the Appeals settlement process have been unsuccessful, a taxpayer can submit a written request to Appeals seeking approval for mediation. Although no formal procedure exists to contest the denial of a mediation request, in practice it is difficult for the Service to deny requests involving eligible issues. The goal of the mediation program is to quickly move each case to resolution. In our experience, an

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Appeals mediation can be completed in approximately three to four months from the date of the taxpayer's written request for mediation.

The taxpayer and Appeals jointly select an Appeals employee who is trained as a mediator to preside over the mediation proceeding. Additionally, the taxpayer may identify an individual not employed by the Service to serve as a co-mediator (the "independent co-mediator"), in which case the taxpayer bears the expenses associated with the independent co-mediator. The purpose of the mediator, or co-mediators, is to facilitate settlement discussions between Appeals and the taxpayer. The parties are not required to adopt any recommendation or proposal made by the mediator or co-mediators. In our experience, taxpayers generally benefit from the inclusion of an independent co-mediator who can provide balance and fairness to the mediation process. Taxpayers typically select as an independent co-mediator an individual who is knowledgeable regarding the tax law and trained in Appeals mediation procedures.

An independent co-mediator is particularly important in cases involving Appeals or Compliance Coordinated Issues. In those cases, the Appeals Team Manager or Case Leader often is required to defer to the Appeals or Compliance Issue Coordinator in negotiations during the traditional Appeals settlement process. This deference to the Issue Coordinator frequently makes it difficult to settle coordinated issues in Appeals if the taxpayer is unwilling to accept a coordinated settlement offer that typically does not reflect the hazards of litigation present in the taxpayer's particular case. Unfortunately, that deference to the Issue Coordinator may continue into the mediation process with the Appeals mediator. As a result, the taxpayer can benefit by having an independent co-mediator assess the hazards of litigation and present an unbiased recommendation regarding an appropriate settlement. The Appeals team may be willing to negotiate with the taxpayer if the assessment and recommendation of the independent co-mediator diverges widely from that of the Issue Coordinator. Without an independent co-mediator, the taxpayer is less likely to obtain a different result in an Appeals mediation than that which was offered during the traditional Appeals settlement process.

The standard Appeals prohibition on unsolicited *ex parte* communications extends to the Appeals mediation program in that neither party may initiate *ex parte* communications with the mediator or co-mediators. It is important to keep in mind that the "party" on the other side of the mediation is Appeals, not the taxpayer's exam team, and that the Appeals team (the Appeals Team Manager, Appeals Team Case Leader, and any other Appeals Officers assigned to the taxpayer's case during the traditional Appeals settlement process) may have *ex parte* communications

with others within the Service (such as the taxpayer's exam team and attorneys in the Service's Office of Chief Counsel). Thus, during the mediation process, the restriction that Appeals not have *ex parte* communications is lifted within the Service, except with respect to communications between Appeals, as a party in mediation, and the Appeals mediator.

Either party can walk away from the Appeals mediation process at any time. In our view, however, it is difficult for the Service to walk away from mediation and force the taxpayer to litigate when one of its own employees, the Appeals mediator, is recommending a settlement. The refusal to settle based on the Appeals mediator's proposal would undercut the credibility of the Service in entering into mediations with other taxpayers and ultimately threaten the viability of the program as fewer taxpayers participate.

If the taxpayer and Appeals reach an agreement on an issue through mediation, the standard Appeals case resolution procedures apply, including the preparation of a closing agreement. On the other hand, if the parties are unable to resolve an issue through mediation, they may have the option to arbitrate any unresolved factual issues, although the only recourse for any unresolved legal issues would be litigation. If arbitration is not available, the Appeals process ends, and a statutory notice of deficiency would be issued to the taxpayer.

### Eligibility for Appeals Mediation

Mediation is available for a broad range of issues, including (but not limited to) (1) legal issues; (2) factual issues; (3) coordinated issues, including Appeals Coordinated Issues and Compliance Coordinated Issues (formally known as Industry Specialization Program Issues); (4) certain early referral issues when an agreement is not reached; and (5) issues for which a request for competent authority assistance has not yet been filed. On the other hand, mediation is not available in cases involving (1) issues that have been designated for litigation; (2) collection cases; (3) issues for which mediation would be inconsistent with sound tax administration; (4) frivolous issues; and (5) cases in which the taxpayer did not act in good faith during Appeals settlement negotiations. Because Revenue Procedure 2009-44 does not specifically address whether listed transactions or transactions subject to one of the Service's settlement initiatives are eligible for mediation, those issues would need to be considered on a case-by-case basis to determine whether issue-specific guidance provides that the particular issue is ineligible for the Appeals mediation program.

### Appeals Arbitration

The mediation program is not the only opportunity to settle a case that has not been resolved through the traditional Appeals

settlement process. Taxpayers also can participate in the Appeals arbitration program. The Appeals arbitration program is generally available for cases in which a limited number of factual issues remain unresolved following the traditional Appeals settlement process or Appeals mediation. Arbitration is optional, and both parties must consent to arbitration. Although the timeline for an arbitration proceeding is not as short as that for a mediation, resolution through an arbitration proceeding can be achieved far more quickly than an issue can be resolved through litigation.

Issues eligible for the Appeals mediation procedure are not automatically eligible for the Appeals arbitration program. Arbitration is currently only available for certain factual issues. This means that arbitration basically is unavailable for all other issues including (but not limited to) legal issues, issues already docketed in any court or designated by the Service for litigation, coordinated issues, and issues for which a request for competent authority assistance has been filed.

The parties to the arbitration are required to enter into a written agreement to arbitrate pursuant to which both parties agree to be bound by the decision of the arbitrator. The parties must agree on the selection of the arbitrator, and the arbitrator need not be an employee of the Service. If the parties agree to use an employee of the Service as the arbitrator, the Service will pay all expenses associated with the arbitrator. If the taxpayer desires to have an arbitrator who is not an employee of the Service, the parties may select an individual from any local or national organization that provides a list of neutral arbitrators. The taxpayer and Appeals will share equally the expenses associated with having an independent arbitrator. Other than cost and perhaps the difficulty of identifying a mutually acceptable arbitrator with some knowledge of the federal income tax system, there is little downside to selecting an arbitrator who is not an employee of the Service.

Throughout the arbitration process, unsolicited *ex parte* communications between the parties and the arbitrator are prohibited. Once the arbitration session has begun, neither Appeals nor the taxpayer may withdraw from the proceeding. After the arbitration proceeding has been completed, the arbitrator prepares a written report that renders a final decision on the issues subject to the arbitration proceeding, and Appeals prepares a closing agreement consistent with the arbitrator's findings. Neither party may appeal or contest the arbitrator's final decision.

### Mediation versus Arbitration

While the Appeals mediation program and the Appeals arbitration program are somewhat similar, there are several important distinctions between the programs. First, mediation is available for a much more expansive range of issues than arbitration. Mediation is available for most legal and factual issues, whereas arbitration is limited to factual issues.

Second, there is no commitment made by either party in agreeing to participate in the Appeals mediation program. In an arbitration proceeding, on the other hand, the parties agree to be bound by the determination of the arbitrator, and it is difficult to terminate the arbitration proceeding.

Third, in arbitration, the arbitrator typically is not an employee of the Service. In a mediation proceeding, although the taxpayer can enlist an independent co-mediator, the other co-mediator must be an Appeals employee.

### Conclusion

By issuing Revenue Procedure 2009-44, the Service is reminding taxpayers of the Appeals alternative dispute resolution programs. Given that the Appeals mediation process is non-binding, involves minimal additional costs and time, and provides taxpayers with the opportunity to withdraw from the mediation proceeding at any time, taxpayers should consider entering into the mediation program whenever issues cannot be resolved through traditional Appeals settlement negotiations.

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We will continue to monitor further developments in this area. In the meantime, if you have any questions or concerns, please call any of the following attorneys in our tax group:

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