financial intermediaries gather and transactions occur is that a FTT would work fine if only the United Kingdom and the United States imposed it.

This raises the question: Why shouldn't the United Kingdom keep the entire proceeds of a European FTT? European Commission research estimated that roughly 71 percent of an EU FTT would be paid on British transactions. In essence, an EU FTT would be a British subsidy to the other 26 members. Matheson suggested reallocation of revenue.

Opponents of the FTT love to point to Sweden's disastrous experiment, which saw 50 percent of trades in Swedish shares being executed in London, since the tax only applied to transactions executed by Swedish brokers. Other traders used foreign brokers to buy Swedish shares on behalf of offshore entities.

Sweden's tax rate was one half of 1 percent, which is regarded as very high for a FTT, and twice that rate on options, with the exercise being taxed again as a sale. So participants had a hefty incentive to avoid the tax, which was raised in the second and fifth years it was in effect.

The impetus for the Swedish tax was the view that the financial sector was parasitic and contributing to income inequality. The tax is thought to have caused share price declines by more than the amount of the round-trip tax.

The British stamp tax was formerly collected on foreign transactions when the shares were entered into a foreign clearing service or registered as depositary receipts, like a license. The upfront tax on foreign transactions substituted for uncollectible tax on foreign secondary-market transactions.

This so-called season ticket, imposed at three times the regular rate, seemed like a good idea from an administrative standpoint. But not to the European Court of Justice.

In *HSBC Holdings* (C-569/07), *Doc 2009-21722*, the Court held that it violated the EU directive 69/335/EC prohibiting indirect taxes on raising capital. The Court viewed a tax on entry of newly created shares issued to a foreign clearing service as tantamount to an indirect tax on issuance.

The ECJ quibbles with a lot of tools that are good for tax adminstration but arguably bad for capital mobility, like withholding at the border. So a European FTT would have to take the form of an EU directive, to limit the number of inevitable court challenges. ■

NEWS ANALYSIS

Overcoming Appeals' Bad Rap

By Jeremiah Coder — jcoder@tax.org

Taxpayers have a love-hate relationship with the IRS Appeals Office. While critical to resolving taxpayers' disputes so as to avoid expensive litigation by both parties, the office constantly battles misconceptions about its independence from other IRS functions and criticism about its performance.

The IRS has tried to strengthen procedural rules preventing Appeals from being subject to undue influence by other arms of the Service, including in a recently issued notice addressing ex parte communications between Appeals and other employees. That notice includes a draft revenue procedure that would update the guidance in Rev. Proc. 2000-43. (For Notice 2011-62, 2011-32 IRB 126, see *Doc 2011-15685* or *2011 TNT 139-7*. For Rev. Proc. 2000-43, 2000-2 C.B. 404, see *Doc 2000-26002* or *2000 TNT 197-5*. For prior coverage, see *Tax Notes*, July 25, 2011, p. 352, *Doc 2011-15727*, or *2011 TNT 139-2*.)

But those efforts have received a tepid response from taxpayers and practitioners, some of whom see the changes as one step forward in some areas and two steps back in others. The question remains whether Appeals can reduce taxpayer suspicions.

Maintaining Independence

Despite the long-standing criticism and mistrust of Appeals, Alex E. Sadler of Ivins, Phillips & Barker said that many corporate taxpayers "have a strong interest in avoiding litigation" because going to court can be "expensive, uncertain, and take years to play out." Moreover, as illustrated by significant taxpayer losses in recent years, the outcome of litigation is hardly assured, making clients interested in securing an administrative settlement through Appeals to avoid the judicial system, he said.

"By and large, my experience is that the appeals process is usually pretty effective at facilitating resolution where both parties have a realistic evaluation of the strengths and weaknesses of their positions," Sadler said. "While an administrative settlement is not always possible, most taxpayers make a good-faith effort to resolve their issues in Appeals."

In response to the Internal Revenue Service Restructuring and Reform Act of 1998, Appeals was reconstituted as a separate function within the IRS that reports directly to the commissioner. According to the IRS website, Appeals aims to be "independent of any other IRS office and provides a venue where disagreements concerning the application of

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tax law can be resolved on a fair and impartial basis for both the taxpayer and the government.'' But even with that separation in the IRS, criticism has persisted that Appeals personnel are improperly influenced by other staff. (For related commentary, see *Tax Notes*, Mar. 30, 2009, p. 1591, *Doc 2009-3389*, or *2009 TNT 59-15*.)

> ***'The appeals process is usually pretty effective at facilitating resolution where both parties have a realistic evaluation of the strengths and weaknesses of their positions,' Sadler said.***

It isn't only taxpayers or their representatives who have cried foul. In several judicial opinions, courts have chided Appeals for allowing IRS examination or collection agents to exert undue influence on the disposition of taxpayer matters. In a 2007 Tax Court opinion, Judge Mark V. Holmes said that the prohibition on ex parte communication exists not only to prevent ''actual influence'' on a taxpayer's appeal but also to prevent even ''a reasonable possibility that the prohibited communication may have compromised the Appeals officer's impartiality.'' Ex parte communications ''not only undermine the impartiality of the officer hearing the appeal but are especially pernicious because they are so hard to detect,'' Holmes wrote. (For *Industrial Investors v. Commissioner*, T.C. Memo. 2007-93, see *Doc 2007-10189* or *2007 TNT 79-18*.)

David Robison, a former Appeals chief now at Skadden, Arps, Slate, Meagher & Flom LLP, acknowledged that the process has ''had warts'' but said the long-standing success of Appeals over the decades is a testament to its core operations. ''Appeals has traditionally resolved around 85 percent of the cases it handles, which shows Appeals does its job well,'' he said.

At least one report agreed with Robison's assessment. The Treasury Inspector General for Tax Administration in 2005 reviewed Appeals' operations and concluded that ''the overall independence provided by Appeals' structure and processes appears to comply with the intent'' of the IRS restructuring act. (For the report (2005-10-141), see *Doc 2005-18832* or *2005 TNT 177-17*.)

Sadler said the perception of independence is perhaps more important than the reality. For the appeals process to work, ''independence is clearly important,'' he said. ''Taxpayers need to believe they are getting a fair shake.''

Tension exists because Appeals is within the IRS, and problems can arise when Appeals communicates with other arms of the Service, Sadler said. ''But that problem is pretty well addressed through the IRS's own rules and training and the vigilance of Appeals officers, who are very good at avoiding improper ex parte communications,'' he said. ''Clearly they happen, though.''

Although any communication between Appeals and the exam team might cause a taxpayer to question Appeals' independence, ''my experience is that Appeals officers take their responsibility to maintain independence very seriously and are diligent not to communicate ex parte with exam teams on substantive issues,'' Sadler said, adding, ''I suspect blatant violations of the ex parte rules are quite rare.''

Carol M. Luttati of the Law Offices of Carol Luttati in New York said that in her 27 years of tax controversy work, none of her cases before Appeals ever involved a violation of the ex parte rules. But violations do occasionally occur and are difficult to detect, she said. Sometimes an Appeals officer will mention reaching out to the originating function for clarification, which gives the taxpayer's representative the opportunity to remind the officer that any conversations must include the taxpayer, she said.

''Any case before Appeals already has the benefit of the government's position, so if Appeals wants additional information, it is the taxpayer's chance to respond and demonstrate why a prior action by the IRS was wrong,'' Luttati said. If a representative fears that an infraction may occur, it is best to gently remind the officer of the need to let the taxpayer participate and respond, she said, adding that it is also a good idea to make a Freedom of Information Act request ''to see what activity took place between Appeals and any other IRS personnel.''

Sadler said that although it may be possible to make Appeals more independent by drawing more distinct lines between interactions with various IRS functions, doing so would come at a cost in terms of administration, consistency, and, possibly, the accuracy of results. ''There is a cost benefit analysis that policymakers need to go through,'' he said.

Taxpayer Remedies

Sadler said that in the event of a breach of the ex parte rules, Notice 2011-62 leaves the appropriate remedy ''within the sole discretion of Appeals.'' But the rules ''would be more effective at deterring ex parte violations if they provided aggrieved taxpayers with a specific remedy, such as the right to be assigned to a new Appeals officer in cases of egregious violations,'' he said.

Robison said that Appeals does just that. When the office becomes aware of an ex parte violation, the case is often transferred to new personnel, he said. ''The sensitivity is high toward prohibited

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communications, and Appeals tries hard to administratively deal with a problem when it arises,'' he said.

Sheldon Kay, deputy chief of Appeals, told Tax Analysts that when an ex parte violation occurs, Appeals will ''look to the current administrative and personnel processes'' to develop a case-by-case determination of what remedy would put the taxpayer in the same position as if the violation had not occurred. Courts have acknowledged that that is the proper approach, rather than adopting a bright-line process, he said.

> ***'The sensitivity is high toward prohibited communications, and Appeals tries hard to administratively deal with a problem when it arises,' Robison said.***

However, others would like to see more explicit rules on the consequences of ex parte communication. The State Bar of Texas Section of Taxation, in recent comments on Notice 2011-62, highlighted the lack of firm remedies as one of the greatest procedural shortcomings of IRS action. Leaving it to Appeals' sole discretion in handling a confirmed ex parte violation ''does not go far enough,'' the group said. Taxpayers should be able to either respond to the ex parte communication or request that the case be assigned to a new Appeals officer, according to the report. Arguing that the appearance of independence ''is best assessed from the perspective of the taxpayer,'' the group said that providing taxpayers with those options would allow them ''to weigh the perceived damage arising from the violation of the rules against the effectiveness and the cost and inconvenience of different remedies.'' (For the letter, see *Doc 2011-17676* or *2011 TNT 159-24*.)

A client alert produced by Latham & Watkins LLP also criticized the draft revenue procedure as ineffectual. Despite the ex parte changes outlined by the IRS, ''it is difficult to view the proposed revisions as strengthening the ex parte rule or reinforcing the independence of Appeals,'' the firm said. Allowing Appeals to self-police violations is a ''remarkable'' failure that avoids both transparency and explicit remedies, the alert said.

Latham said that the self-enforcement policy ''remains inconsistent with the practices of other federal agencies'' and advised taxpayers to be vigilant in finding instances of prohibited communications and asking for the opportunity to participate. Without further changes, the updated procedures only ''emphasize a view that the ex parte rule is more about form than a true prohibition,'' the firm said.

The American Bar Association Section of Taxation said in an August letter to the IRS that the absence of meaningful remedies makes the concept of ex parte prohibitions ineffective and diminish the confidence that taxpayers have in the ability of Appeals to remain independent. Establishing a dedicated ex parte compliance function in Appeals would send a message that violations are taken seriously, the group said. Requiring that taxpayers receive prompt notification of ex parte rule violations would promote transparency that would in turn increase public confidence in the system, the group said. (For the letter, see *Doc 2011-18520* or *2011 TNT 170-19*.)

Patti Burquest, managing director of RSM McGladrey Inc.'s tax controversy services, said that in developing an adequate remedy for violations of the ex parte rules, one approach is to look at how a particular solution provides incentives for IRS employees. ''Does the organization strongly communicate the belief that there should not be hidden communications that could influence the outcomes and back those communications up with some sort of follow-up?'' she asked.

Like other critics of the IRS guidance on ex parte communications, National Taxpayer Advocate Nina Olson believes the IRS's rules should be more formal. In her 2010 annual report to Congress, Olson urged the IRS to put ex parte guidance out as a Treasury regulation, arguing that it would increase the importance of the issue in the minds of IRS personnel and ''afford the regulations greater judicial deference.'' (For Olson's report, see *Doc 2011-220* or *2011 TNT 4-23*.)

Olson highlighted issues associated with Appeals' independence as one of the ''most serious problems'' facing taxpayers and recommended that Appeals institute a ''formal system to document and track ex parte communications.'' Having a formal, centralized system of documenting ex parte communications would give Appeals concrete data with which to assess the frequency and seriousness of potential violations of taxpayer involvement, Olson said.

Outside Influence

A source of consistent taxpayer concern when it comes to independence is Appeals' interaction with the IRS Office of Chief Counsel in obtaining legal advice. While no one questions the need for Appeals to have access to legal guidance, the limitations placed on that process can lead to significant distrust.

According to the Latham alert, the strictures of Rev. Proc. 2000-43 are being weakened to allow chief counsel more leeway in offering advice that may influence the outcome of Appeals cases. The draft update of the revenue procedure's prohibition

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on advice only from IRS attorneys when the attorney personally advised Appeals on the issue in the same case is a ''substantial step backward for taxpayers,'' the firm wrote. The new notice ''has shifted the ground from a bright line rule that reflected concern with the *appearance* of Appeals' independence to a murky substitute,'' the firm said (emphasis in original).

In an August letter to the IRS, the Texas Society of Certified Public Accountants argued that rather than allowing a ''blanket exception for ex parte communications with Chief Counsel by Appeals,'' the Service should adopt an updated rule to ''require segregation of any Chief Counsel personnel who participated as a member of the audit team.'' That move is necessary because ''taxpayers will only use the appeals process if they believe it is unbiased and impartial in its deliberations and findings,'' the group wrote. (For the letter, see *Doc 2011-17692* or *2011 TNT 160-17*.)

> ***'Taxpayers will only use the appeals process if they believe it is unbiased and impartial in its deliberations and findings,' the Texas Society of Certified Public Accountants wrote.***

In its letter, the ABA tax section criticized the IRS for ''abandoning the bright-line rule in favor of a subjective standard that is susceptible to a range of interpretations.'' Drafting the prohibition using vague terms ''will both diminish transparency and provide ample fodder for linguistic debate,'' the group warned.

Burquest said the draft revenue procedure creates a ''great safeguard'' in limiting the role of chief counsel employees who may have provided advice on an issue at the exam level. But she expressed concern that in some geographic locations where Appeals and chief counsel work together closely, preexisting relationships ''could color Appeals' view of the advice.''

''I would hope the advice that is provided adequately lays out both sides of the issue so that hazards of litigation can be assessed,'' Burquest said.

Burquest said that the interaction between Appeals and chief counsel can be a problem because Appeals personnel often only ''pay lip service'' to the fact that they aren't required to follow technical advice. ''When chief counsel has provided advice on the case in front of Appeals, I find that proposition questionable,'' she said. ''The Appeals officer is likely to follow the advice.''

Diane Ryan of Skadden, who had a lengthy tenure in Appeals and most recently served as chief of Appeals until departing the IRS last May, argued that one of the most striking features of the draft revenue procedure ''is that front and center is a provision that clearly states Appeals is not bound by counsel advice.'' She added, ''That may seem like a small thing, but it is actually a big deal declaring it publicly'' because it greatly enhances the profile of that rule within the organization. The internal impact on Appeals officers of that statement will be to emphasize that they ''need to listen 360 degrees'' around them to all perspectives, she said.

Robison said that in his experience, Appeals officers rarely sought chief counsel's advice. Senior Appeals officers ''have a good view of what they can and can't do with counsel advice,'' allowing them to make good judgment calls, he said.

Issue Coordination

A more serious issue regarding independence is the coordination of resolution of issues and transactions within the IRS on an agencywide basis. ''Even while I understand the need to coordinate for consistent issue treatment and to ensure that Appeals officers are knowledgeable about key legal principles, issue coordination certainly diminishes the availability of independence,'' Sadler said. ''In my judgment, there has been overcoordination, which has diminished the effectiveness of the appeals process.''

While more subtle than ex parte communications, any time Appeals coordinates a position with other IRS functions, it tends to undermine the perception that Appeals is an entirely independent decision-maker, Sadler said. ''Coordinated positions can lead to rigidity in Appeals and a feeling by taxpayers that they're not being heard out,'' he said. ''In this regard, Notice 2011-62's proposal for Appeals to no longer participate on issue management teams and the reduced emphasis being given to coordinating issues are both positive developments.''

> ***'Notice 2011-62's proposal for Appeals to no longer participate on issue management teams and the reduced emphasis being given to coordinating issues are both positive developments,' Sadler said.***

Ryan said that the decision to remove Appeals technical guidance coordinators from the issue management team structure is an example of IRS Commissioner Douglas Shulman's commitment to Appeals' independence. ''That was a groundbreaking, positive signal to external stakeholders and

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went directly to the perception of Appeals' independence," she said. "The commissioner is a strong advocate of independence, helping Appeals to flourish."

Kay said that despite the removal of Appeals technical guidance coordinators from issue management teams, Appeals officers can still get briefings from issue management teams and can retrieve information from other available sources, as they previously have done. Appeals is also working on the rules of engagement for officers' interactions with the compliance functions so that the perception of Appeals' role and independence is strengthened, he said.

But Burquest said that Appeals' past participation on issue management teams is more fodder for critics of the office's independence. "Appeals is sometimes seen as becoming a strong advocate for a position in line with exam because they have participated in developing the issue management strategy as a member of the same team," she said. That can inhibit settlements that would have routinely been resolved by Appeals, such as research credit issues, absent the issue management team structure, she said.

The IRS's announcement that Appeals will no longer formally sit on the issue management team "doesn't do much to publicly relieve that pressure, as it is nearly impossible for an Appeals technical guidance coordinator to listen in to issue discussions that won't involve some specific case examples, and those cases could ultimately involve the Appeals technical guidance coordinator in the settlement discussions," Burquest said.

Limited Staff and Resources

Ryan said that practitioner criticism of Appeals is often made without acknowledging the office's limited resources. "The proper focus is what is possible when it comes to making changes within Appeals," she said, adding that settlement decisions by Appeals personnel must be made in an environment circumscribed by multiple factors.

The office has demonstrated efficiency as its caseload has increased dramatically while its staffing level has remained fairly consistent, Robison said. "Staffing imbalance is a concern to maintain timeliness of resolution," he said, adding that Appeals has little control over the number of cases it receives. "Appeals is at the end of the pipe with no control valve," he said.

Also helping ensure Appeals' independence is the courage and confidence that Appeals officers gain from years of experience, Ryan said. "That takes time, so with 75 percent of large-case Appeals officers eligible to retire within the next 18 months, that leads to some concern for the organization," she said. "You have to think how Appeals is going to train new staff and shorten the learning curve."

Kay said that given the potential for a high turnover rate among staff, Appeals has embarked on a pilot readiness program to put senior officers on a team with team case leaders to allow the younger personnel to learn from experienced staff. Appeals is training lower-grade employees to qualify for higher-level positions and is identifying new frontline managers, he said.

> ***'We want to make sure that all IRS technical employees have training that is tailored to the types of instances and scenarios that are relevant to their type of work,' Kay said.***

Kay said that Appeals is working with each of the IRS business operating divisions to produce customized training. "Because ex parte communications can be different in each setting, we want to make sure that all IRS technical employees have training that is tailored to the types of instances and scenarios that are relevant to their type of work," he said.

Ryan emphasized that "the responsibility is on everyone" to ensure that no ex parte violations occur. Making the rule more widely known across the IRS "will go a long way toward making sure the appropriate filters and fences are up," she said.

Appeals Alternatives

Burquest said the increase in alternative dispute resolution programs being promoted by the IRS is a positive step. "I don't view prefiling agreements or participation in the compliance assurance program as an end run around Appeals," she said. New alternative dispute resolution tools "provide a way to take issues off the table, and their increased use doesn't reflect on Appeals' performance," she said. To the extent that taxpayers have been hesitant in going to Appeals with unresolved issues, it is in part the result of the appearance of a "team approach" that Appeals has with functions of the IRS, she said.

A constant criticism of Appeals over the past decade has focused on the timeliness of its work, with cases often taking more than a year to reach resolution, Burquest said. But the introduction of new programs, such as the fast-track settlement process, has helped win praise by establishing limited time frames for action and giving employees less paperwork, she said.

According to Ryan, fast-track mediation has proven popular with Appeals employees, in part

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because officers get to use all of the traditional resolution tools without the administrative burden. ''There is a certain elegance to fast-track sessions because now everyone is in the room together,'' she said.

Sadler agreed that for some taxpayers, alternative dispute resolution programs can be effective in resolving tax issues rather than traditional Appeals processes. For example, the real-time and cooperative nature of examinations under the compliance assurance process (CAP) program reduces the number of issues that go to Appeals, he said, adding that the flow of information between the parties allows the taxpayer and the CAP team to identify early the issues that won't be agreed on and to take the steps necessary to get the cases ready for Appeals.

Although frustrated taxpayers infrequently use post-Appeals mediation, it ''is a viable last-ditch effort to avoid litigation,'' Sadler said. ''In my experience, mediation is most likely to achieve a settlement where the Appeals team manager is invested in resolving the issue and where the taxpayer pays for a non-IRS co-mediator to participate in the process,'' he said.

> ***Fast-track mediation has proven popular with Appeals employees, in part because officers get to use all of the traditional resolution tools without the administrative burden, Ryan said.***

Sadler said the fast-track settlement process ''is most likely to work when the taxpayer and exam team have discussed a framework for settlement, or the exam team has at least expressed some level of commitment to resolve the issue.'' The program is less likely to be successful when the issue is highly contentious and the parties' positions are far apart, he said.

Burquest said that one downside of the fast-track program is that exam has to agree with placing an issue into the fast-track pipeline, and that exam's continued involvement can interfere with settlement of the case.

Kay said that the finalization of fast-track settlement procedures for the Tax-Exempt and Government Entities Division and the Small Business/Self-Employed Division, as well as changes to how the Large Business and International Division tracks cases, are continued improvements that Appeals is making to resolve taxpayer cases more efficiently and impartially. In particular, there has been a nearly 50 percent increase in LB&I fast-track settlements over the prior year, he said. Also, Delegation Order 4-25 gives revenue agents in large cases the ability to resolve matters consistent with Appeals settlement guidelines, he said.

Gaining Respect

Appeals is an important and attractive avenue of issue resolution for many taxpayers. The main drawback is some taxpayers' belief that the office has too much of an exam mentality to offer an impartial review that might result in a more favorable mechanism to closing outstanding tax issues.

While the office has taken significant strides toward addressing public concerns over its operations, its ability to offer continued successful resolution tools is only as strong as the trust that taxpayers place in it. Concern over the influence of non-Appeals personnel is a formidable obstacle that may not have a completely effective prevention strategy, but any procedural steps that further deter prohibited ex parte communications and increase Appeals' independence can only help effectuate Congress's vision and improve taxpayers' perceptions. ■

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