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KPMG in the US



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Underutilisation of ADR programmes harms tax administration in the US

Mark Martin and Thomas Bettge of KPMG in the US discuss IRS alternative dispute resolution (ADR) and prevention programmes and how their underutilisation impedes effective tax administration.

The IRS has developed a wide array of ADR and dispute prevention programmes aimed at expediting case resolutions and easing the strain on the traditional disputes process. Issues that are unagreed following an examination proceed to consideration by the IRS Independent Office of Appeals and then, if needed, to litigation. The menu of options – Accelerated Issue Resolution, early referral to Appeals, the Rapid Appeals Process, settlement pursuant to Delegation Order 4-24, and Fast Track Settlement, to name only some – can be bewildering. Not every procedure is available or appropriate in every case.

More concerningly, taxpayers, practitioners, and even IRS personnel are often unaware of options for ADR. As a result, it sometimes seems that the IRS' ADR programmes are offered more in theory than in practice. A May 2023 report from the Government Accountability Office (GAO) looked at several IRS ADR programmes and found that they were seriously underutilised. During the decade spanning the government's 2013 to 2022 fiscal years, the ADR programmes examined by the GAO were used to resolve only half a percent of all cases that required IRS Appeals review, and the use of the programmes dropped 65% over the same period.

Of the programmes examined by the GAO, the IRS Large Business & International (LB&I) division's Fast Track Settlement programme is most frequently relevant for large taxpayers. Fast Track involves a mediation between the taxpayer and the IRS examination team, with an Appeals officer serving as the mediator. The goal of Fast Track is to resolve cases within 120 days, and the IRS data reported by the GAO shows that the IRS

is generally successful in achieving this aim: the average time to close LB&I Fast Track cases from 2013 to 2022 was 102 days. By introducing an independent mediator, Fast Track can help to resolve disagreements at the examination level, without the need for the taxpayer to prepare a full protest and proceed to the Appeals process. Moreover, while IRS examination teams are only permitted to reach settlements on principled bases, Appeals involvement in Fast Track allows for resolutions that consider the parties' respective hazards of litigation. Fast Track can therefore facilitate resolution in cases where the taxpayer and the IRS examination team have reached a tentative settlement but the examination team believes it lacks the authority to enter into that settlement without Appeals involvement.

Unlike Appeals, reaching a resolution in Fast Track does not preclude access to the mutual agreement procedure (MAP). However, signing a closing agreement, Form 870-AD, or similar agreement following Fast Track, will prevent the U.S. competent authority from deviating from the terms of the settlement, meaning that it will only negotiate for correlative relief from the partner jurisdiction. In such a case, the MAP process is unlikely to produce a result that alleviates double taxation.

In our experience, Fast Track can be a very useful tool for resolving cases at the examination level. To give one example, following a contentious examination, the taxpayer requested Fast Track Settlement and the examination team – despite viewing challenging valuation issues in a manner diametrically opposed to the taxpayer's position – was eager to participate. Fast Track quickly led to a mutually acceptable settlement on a lump sum basis. Yet the same case illustrates the problems with the IRS' application of Fast Track: the IRS revenue agent, despite his many years of experience, had never previously participated in a Fast Track Settlement mediation.

The GAO report does not address dispute prevention programmes such as prefiling agreements, but similar issues with underutilisation exist there. The prefiling agreement (PFA) programme allows the IRS, at the taxpayer's request, to examine certain eligible issues prior to the filing of the taxpayer's return. Unlike Fast Track, which is free, taxpayers seeking PFAs are required to pay a user fee. The PFA programme provides an opportunity for the taxpayer and the IRS to resolve any issues and reach agreement before the return is filed, giving certainty to the taxpayer that the return position will be accepted. PFAs are particularly useful for

taxpayers grappling with complex issues, such as worthless stock deductions and research credit issues. Unfortunately, like the ADR programmes analysed by the GAO, the PFA programme has fallen into relative disuse: from 2019 to 2022, only nine PFAs were accepted by the IRS, and only eight were closed.

Frustrating as it may be to see helpful IRS ADR and dispute prevention programmes go broadly unused, the GAO report is ultimately good news. By turning the spotlight on the untapped benefits of ADR, it should focus the IRS' attention on improving and promoting these programmes, and should encourage taxpayers, practitioners, and IRS personnel to take advantage of the benefits of the IRS ADR and dispute prevention programmes.

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