

Phase II of AJAC may increase US litigation

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Phase II of the Appeals Judicial Approach and Culture (AJAC) project in the US provides that the Appeals division of the Internal Revenue Service will not accept new cases unless there is at least 365 days remaining on the statute of limitations, but this may lead to more cases heading for litigation.

The AJAC project, which was first implemented on July 18 2013, has helped shift the focus of Appeals to resolving disagreements between taxpayers and the government, rather than engaging in fact finding or merely being used as an extension of the examination process.

Phase II of the project states that Appeals will not accept new cases unless there is at least 365 days remaining on the statute of limitations. In the past, only 180 days was needed, and Appeals had discretion to offer a statute extension to taxpayers whose statute of limitations was less than 180 days from expiration.

"While AJAC is well-intentioned, the 365-day rule, may wind up increasing the number of cases proceeding to litigation," said Daniel Rosen of Baker McKenzie. "If the audit's conclusion is within 365 days of the statute of limitations expiration date, Appeals will neither accept the case nor solicit a statute of limitations extension from the taxpayer."

"Under AJAC, the IRS examination function has essentially been given control over whether the taxpayer gets pre-litigation Appeals consideration by controlling the timing of the audit's completion: the taxpayer is at the mercy of the IRS examination function to offer an extension to the statute of limitations in such a case," added Rosen. "However, a taxpayer is not legally entitled to an extended statute of limitations, and the IRS is under no legal obligation to acquiesce to a taxpayer's request for an extension."

The main objective of the project is to promote a quasi-judicial

approach at a time when resources are limited and to try and improve perceptions both internally and externally of the Appeals function. Overall, the project has been a success, but there are a few grey areas in the AJAC programme, which have led to a lack of certainty for taxpayers.

"It remains unclear the extent to which taxpayers may raise new arguments as opposed to new facts, the latter of which could result in the case being sent back to the Examination division for reconsideration or evaluation," said Mark Allison of Caplin & Drysdale. "We have observed this tension in cases where taxpayers develop new arguments in the protest to the Appeals division in response to the Examination division's proposed adjustments, but which the Examination division may assert requires new consideration by its function before the case can be referred to Appeals."

"This creates a circular problem because every time the taxpayer reacts to a new position by Exam it could be viewed as a new fact and the cycle cannot be broken," added Allison.
