How Can an Excessive Volume of Tax Disputes Be Dealt With?

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Summary

Many countries experience problems with tax disputes. In some, a serious backlog of tax cases threatens revenue collection. This paper discusses a range of approaches to reducing the number of cases that go to court, thereby providing background information that can be consulted in dealing with this problem. Mechanisms for dispute resolution in a particular country should, of course, be tailored for the specific country, in light of the institutions, tax administration needs, current practice, and legal framework of that country. In this paper, emphasis is placed on avoiding disputes at the earliest possible stage, and resolving as many disputes at the administrative level as possible, consistently with protecting taxpayer rights. Appropriate organization of the appeals function within the tax administration is discussed in detail. Country examples of dispute resolution techniques are given. At the end of the note, a checklist of measures that could be considered to reduce the volume of tax disputes is provided.

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Acronyms

ADR     Alternative Dispute Resolution
AO      Abgabenordnung (Germany)
APA     Advance Pricing Agreement
ENE     Early Neutral Evaluation
FTA     Forum on Tax Administration
HMRC    Her Majesty’s Revenue and Customs
I.R.C.   Internal Revenue Code (U.S.)
IRS      Internal Revenue Service (U.S.)
SARS    South African Revenue Service
1. INTRODUCTION

1. A certain level of tax disputes is a normal part of a system of taxation based on the rule of law. Some countries, however, experience an excessive volume of tax litigation. This may involve a high volume of litigation challenging tax assessments, delay in resolving these disputes, and – often – a lack of capacity in the judiciary. A lack of capacity might arise from an insufficient number of judicial personnel or a lack of the needed expertise, and can result in delay and poor quality of the decisions taken.

2. Excessive tax litigation can lead to a delay in collecting a large amount of tax. Protracted tax litigation can also be costly for the private sector, both by way of litigation costs and uncertainty created.

3. It is impossible to determine whether the volume of disputes is excessive based alone on statistics for the number or percentage of assessments disputed. Many factors might influence the volume of disputes. For example, if tax assessments tend to be aggressive, then the volume of disputes will, ceteris paribus, be higher. (In turn, a number of factors, including incentives in the functioning of the tax administration bureaucracy, and tax administration policy decisions, can influence the degree of aggressiveness.) If tax audits tend to focus on obvious cases of noncompliance (as opposed to issues where opinions on how the tax law should be applied might differ), the assessment may not leave much room for dispute. Complex or unclear tax laws might lead to a higher level of disputes. Cultural attitudes can influence the degree to which taxpayers tend to dispute administrative findings. While there is accordingly no benchmark level of tax disputes, it may be quite easy to identify situations where the level of disputes is too high for the system to handle. This might show up in the amount of time needed to process disputes, an increasing backlog of cases, and a substantial volume of outstanding arrears.

4. In assessing whether there is a problem with excessive disputes, attention should also be paid to whether there is a particular problem in a subset of disputes. A small volume of high-value cases which are stuck for a long time in the judicial system may pose as serious, or a more serious problem for the tax administrative system than a large volume of small tax cases. The latter might be annoying but not so dangerous for the revenue. Another possibility is that there is a large volume of cases, but they mostly involve a common type of issue. The solution for this might be different than for a generalized backlog of cases.

5. Ultimately, a judgment must be made whether the volume of disputes is causing problems for effective tax administration. If it is, then addressing this issue needs to be a priority. Even if it is not, of course, that does not rule out reforms, although they may take a lower priority in comparison with other challenges for the tax administration. Reforms might be warranted, for example, in order to save costs by improving the efficiency of tax administration.

6. Some countries experience the opposite problem, namely the existence of very few tax appeals. This can be a symptom of a poorly functioning tax audit program, since if audits
are not conducted energetically there may be little occasion to dispute audit results. It can also be a symptom of corruption in the audit process.

7. There are different types of tax litigation, including challenges to collection actions or requests for information, constitutional challenges, and miscellaneous challenges to the exercise of administrative power through judicial review. This paper does not review tax litigation comprehensively, but focuses on appeals from tax assessments. Problems of excessive litigation affecting the tax administration can, of course, arise in areas other than appeals from tax assessments. Some countries might experience a bottleneck in enforced collection, arising from the need to go to court to enforce tax debts and the inability of courts to handle these cases expeditiously. Another example of litigation that does not involve appeals from assessments is civil litigation to enforce unpaid bills. Such litigation might be encouraged by rules in the tax laws allowing a deduction for bad debts only if measures have been taken to pursue the debtor in court. The remedies to deal with this problem are quite different from those discussed in this paper. The main remedy might be to change the substantive tax laws to remove the requirement to go to court in order to get a tax deduction for bad debts.

8. The discussion in this paper is general, since countries of all sorts can experience problems with tax litigation. However, the paper is likely to be of greater relevance to countries suffering from disfunctionality in their current dispute resolution mechanisms, particularly those suffering an acute backlog of tax cases. The paper does not attempt to analyze how one might go about deciding what dispute resolution institutions and procedures are appropriate for a given country. As with many questions of legal reform, coming up with solutions for a particular country should be preceded by a study of the existing situation, including the legal system and the functioning of the tax administration, the extent to which the authorities are interested in reform, and the timelines involved. One must begin by learning how the existing system is working and what are the main problems presented in the particular country in question before solutions can be recommended. Each country’s case is unique. This paper can serve merely as a reference for some of the possible approaches.

9. The paper sometimes refers generally to common law and civil law countries. This should be read with a caveat that there is much variation within each group.

10. A number of factors can contribute to an excessive volume of appeals. A long-term solution to the problem may involve making changes in several aspects of tax administration and procedure, depending on what is contributing to the level of disputes. Tax disputes can be reduced by measures relating to:

- taxpayer behavior before the tax return is filed (pre-filing measures);
- the audit process; or
- the procedure following the making of an assessment.
II. PREFILING MEASURES TO AVOID DISPUTES

11. The specific ways to avoid disputes before a tax return is filed relate directly to the problem of interpretation of tax laws. If taxpayers have a clear understanding of their obligation, a greater number of them will be inclined to comply appropriately, thereby reducing the potential for dispute with the tax administration.

12. Of course, if there is a culture of aggressive tax avoidance, then many taxpayers will still avoid tax even if they understand their obligations. Changing taxpayer avoidance culture is an important way to reduce disputes, but tends to require a longer-term effort involving a more effective tax audit process and a credible threat of penalty upon discovery.

13. Undue complexity of tax laws and an excessive rate of amendment can lead to disputes. It is important that tax laws be technically well drafted, with care for precise language and policy that avoids legal distinctions that lead to problems of application. Complexity and changeability of tax laws cannot be totally avoided, but should be minimized.
14. One of the most effective ways to reduce disputes is to implement systems to inform and assist taxpayers in accomplishing their duties. Improved compliance will allow some taxpayers to escape audits and assessment of additional tax altogether. This can be done using a number of tools:

   a) **General rulings or other published statements of the tax administration on specific topics (circulars, practice notes, and the like)** can be helpful, even if not legally binding, given the interest taxpayers have in avoiding problems with the tax administration.

   b) **Binding private rulings issued at the taxpayer’s request** can be especially appropriate for transactions where a large amount of tax is involved. Mandatory publication of private rulings (redacted to protect taxpayer privacy) is recommended as a way of providing transparency, assuring high technical standards, and avoiding corruption and favoritism.

   c) **Advance Pricing Agreements** set in advance the specific method which the taxpayer is to use to determine acceptable transfer prices, and thereby can eliminate disputes arising from transfer pricing audits.

15. A generally cooperative attitude of the tax administration can avoid conflicts or speedily resolve them. This cooperation can be enhanced in special programs with the largest taxpayers.

16. Changes in tax policy can reduce the number of disputes. Amending a rule to make it easier to administer (for example, making it a bright-line rule) can be an effective means of reducing the number of disputes arising from audits.

III. AVOIDING CONFLICTS DURING AUDITS

17. In self assessment systems, audits are a key source of disputes. These tend to appear formally at the end of the procedure, as a challenge to the tax assessment by means of a protest.

   A. **Dealing with disputes during the audit procedure**

18. Disputes can arise at any point during the audit procedure. An attempt should be made to resolve most of them before the audit is concluded. Good training and reasonableness of tax auditors are important in achieving this goal, since informal agreements are an unavoidable feature of the audit procedure.

19. This is because administrative practice in tax audits is marked by two circumstances:

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1 In systems involving assessment of tax by the tax administration, the mechanisms in place to assess the tax will pose similar problems (likely in a less intensive manner) as those arising in the audit procedures.
a) The impossibility of covering the whole scope of tax law. Tax rules are numerous, detailed, and difficult to understand even for experts.

b) The impossibility of covering all the possibly relevant facts. The facts in tax issues are both extremely numerous and may or may not be relevant, depending on how the tax administration characterizes them and applies the law.

20. As a result, audits commonly involve a large number of mutual agreements between the auditor and the taxpayer. For example, if the size of a company makes it physically impossible to check invoice-by-invoice all travel expenses, an agreement may be reached between the auditor and the taxpayer, either to extend the results of the analysis of a sample or to fix a specific percentage or amount as being considered deductible.

21. In cases where the audit procedure results in a formal record of the proceedings, a proper documentation of the agreements reached during the audit procedure is advisable.

B. Dealing with disputes at the end of the audit procedure

22. The audit procedure normally concludes with the report of the tax auditor, including the corrections deemed appropriate. In most countries this does not yet constitute an administrative assessment.

23. The tax auditor reflects in the report the results of the audit work relating to both the facts and the applicable law, with the proposed tax assessment which will be formally made by the officer in charge of the audit section.

24. Many jurisdictions provide for the taxpayer’s agreement or disagreement with the tax auditor’s proposal to be taken into consideration. In case of disagreement, the legislation typically provides for a period of argument by the taxpayer that is not yet considered within the appeals/protest system as the administrative decision is not yet deemed taken. Some countries include a sort of mediation/conciliation mechanism such as the intervention of the manager or of a third party, outside the audit section but inside the tax administration (who could be an appeals official) preferably in a flexible way, as a personal meeting with a short and simple written account of the result, preferably following a pre-designed form.

25. In cases of agreement, its legal status (i.e. its binding nature for both the taxpayer and the tax administration) should be made clear by the legislation. This implies that no appeal should be allowed in cases where an agreement is reached. (An exception might be where the legal framework allows the parties to reach agreement on some issues only, with others being able to go forward in the dispute resolution process.)

26. Although there is an important component of negotiation in the audit procedure, the agreement should not entail any reduction in tax that is clearly due. Reasonableness should mean listening and understanding the taxpayer’s position but never accepting unreasonable demands just to avoid conflicts.
27. On the other hand, an automatic reduction of the penalty could be considered in case the taxpayer agrees with the assessment, as this reduces the volume of litigation. Such a reduction of penalty is not a universal, or perhaps even a majority approach, however, as it could be considered as constraining the taxpayer’s right to appeal.

IV. PROTEST/APPEALS SYSTEM

A. Tax protests

28. When the taxpayer does not agree with the assessment, the protest procedure ensues. Protests may arise in at least the following situations:

1. The taxpayer does not want to abide by the tax laws.

2. The taxpayer pursues an unreasonable position.

3. The tax authority has made a mistake.

4. The facts are in dispute.

5. There are doubts concerning the interpretation of the tax laws, thus requiring a decision by the courts.

29. The first two cases are symptomatic of a taxpayer culture of challenging tax assessments frequently, even where the assessment is justified. This might have to do with any number of factors, including rules about requirements to pay tax pending appeal and interest rates on tax debt (both discussed below), corruption, or the corrosive effect of tax amnesties.

30. Frequent protests by taxpayers should alert authorities to the possibility of unreasonableness on the part of tax administrators. Administrative behavior is an important cause of litigation. Tax officials may take an inflexible attitude in viewing the facts and interpreting the law, which can be reinforced by incentive systems that reward additional amounts assessed. This may lead to overly aggressive assessments, and hence to disputes. Lack of sufficient legal background and operational training can contribute to this result. Deficient organization and functioning of the tax administration can also play an important role. A lack of internal control and weak management may give excessive power to tax officials, which could be misused, while on the other hand rigid control over tax auditors can hinder them from exercising discretion that could avoid litigation. Unreasonably high assessments can also be part of a tax administration strategy to pressure taxpayers to negotiate a case, arising from a requirement to pay the full amount of the assessment in order to appeal, in a country having such a rule.

31. Excessive assessments can also result from an administrative culture that favors following fixed rules rather than allowing tax inspectors to exercise discretion. There may be good reasons for such an approach, for example a concern for the principle of legality or a fear of corruption on the part of tax inspectors. On the other hand, such an administrative
culture might lead to a greater amount of litigation, since it is less likely for the taxpayer to be able to work out a satisfactory outcome with the tax inspector than under a system where the auditor enjoys greater discretion.

32. When the tax administration has a clear view on a case described in point 5 above, a court decision should be sought as soon as possible. The tax administration should have the option of referring the matter directly to court after the taxpayer’s protest, without needing to go through the administrative system of resolving disputes. Once a court has rendered a decision, it will provide guidance for similar future cases.

33. The fourth and fifth scenarios listed above are the only ones in which it would be reasonable for a case to go to court. However, the tax administration should avoid disputes on facts where possible. Only in rare cases could litigation on facts be advisable. If agreement is not directly reached by the tax auditor, the aforementioned mediation techniques could be an advisable tool to avoid this type of litigation.

34. There may be a reasonable case for litigation “on facts” when these are so intertwined with legal considerations that what is really at stake is the interpretation of a law. When this is the crucial point for the tax administration, there may be a case for litigation.

35. Administrative mistakes should never result in a conflict outside the tax administration. The best way to avoid them is having a well organized, well trained and well managed tax administration, which is particularly important for the tax audit function. Two different kinds of mistakes can be differentiated: (1) decisions that are not likely to be upheld by the courts, since they are not in accordance with the applicable laws; (2) inadvertent errors.

36. Both are very different in nature, requiring different treatment. While for the first type of mistake the protest system inside the tax administration makes sense, as it gives the tax administration the opportunity to reconsider the case, appeals before a court should not be required, as the tax administration should be ready to recognize its own mistakes when analyzing the taxpayer’s protest.

37. In the case of inadvertent errors, not even the normal protest system should be needed. An informal system should be available to taxpayers, affording them the opportunity to request the correction of such mistakes, within the deadlines provided for by the statute of limitations. However, the normal protest/appeals system should continue to be available to the taxpayer in such cases if needed.

B. Issues in designing an appeals system

38. The following issues arise in designing an appeals system:

a. **Decisions qualifying for protest/appeals:** Should all administrative decisions be subject to protest/appeal, or only some of them?

b. **Common or separate approach:** Should all decisions arising from the same audit be reviewed together, even if they relate to different tax periods?
c. **Immediate or deferred collection of the tax:** Is the tax to be paid pending protest/appeal?

d. **Payment of interest:** If the tax is not paid before the protest/appeals procedure, does the taxpayer have to pay interest on the amount due? If the tax is paid, does the administration have to pay interest on the amount paid if, after the appeals process, it is refunded?

e. **The burden of proof and presentation of evidence:** Is the burden of proof on the taxpayer to show that the tax assessment is incorrect, or does the tax administration have to prove its correctness? In the course of appeal, can taxpayers change their previous representations of the factual situation?

f. **Scope of review:** Can the reviewing body substitute its own rationale or is it limited to reviewing errors committed by the administrative decision or by previous instances? Can the reviewing body take into consideration legal reasons not alleged by the parties? To what extent can it change the facts considered proven by previous instances?

g. **The effects of administrative silence:** When the protest/appeals is not answered in due time, shall it be considered rejected or accepted?

h. **Representation of the parties:** Do taxpayers need a representative in the procedure? Who should represent the tax administration before the courts?

i. **The prohibition of “reformatio in peius”:** Should the rule prohibiting the worsening of a taxpayer’s situation as the result of a protest or appeal be observed?

j. **Penalties for frivolous appeals and reimbursement of litigation costs to prevailing taxpayers:** Should a penalty for frivolous appeals be imposed? Should the tax administration pay litigation costs to prevailing taxpayers?

39. The way these questions are addressed may play a significant role in avoiding or fostering tax disputes.

**Decisions qualifying for protest/appeals**

40. In principle, the rule of law calls for every tax administration decision to be subject to judicial control.

41. In the course of every tax proceeding, several decisions are taken that are not final. A decision that is not final should not qualify for protest/appeal, as it can be subject to judicial control in the procedure dealing with the final decision. One way to distinguish between final decisions (appealable) and non-final decisions (not appealable) is to list all the appealable decisions in the tax procedure code or equivalent law. This approach makes it clear which decisions are appealable and which are not.

**Common or separate approach**

42. The administrative decision being protested often refers to several taxes and time periods. Although they can be joined together in the same audit report, from a legal point of view they are generally considered separate assessments related to each tax and period.
involved. The same may happen with penalties and interest, which conceptually will often be considered as distinct.

43. A decision has to be made on whether these separate decisions have to be dealt with together or separately in the protest/appeals procedure.

44. There are good reasons for a common approach, and no substantial arguments in favor of dealing with them separately. As the questions in dispute in different taxes/periods are often related, dealing with them together saves resources and avoids losing the same perspective for the same problem related to different taxes/periods. Moreover, the assessment could involve both negative and positive amounts for different taxes/periods. Dealing with all these cases together allows for easy compensation between obligations to pay and rights to refund.

45. The approach could vary in the case of penalties, as in some countries there could be constitutional constraints to dealing with them together with the tax under the same procedure. Where constitutionally allowed, for efficiency reasons an effort should be made to deal with penalties in the same procedure as for the tax, particularly for penalties the amount of which depends on the amount of tax.

**Immediate or deferred collection of the tax.**

46. Once the tax is assessed it has to be paid within the time fixed by the law. The question is whether the protest/appeal suspends this obligation. This tends to be treated differently in common and civil law systems. In common law systems, the taxpayer typically does not have to pay the tax when the taxpayer protests/appeals, until there is a court decision.\(^2\) Civil law systems more often require the taxpayer to pay the tax assessed, although most countries provide for the suspension of tax collection under certain circumstances.\(^3\) Many systems provide for suspension of the payment obligation while the administrative appeal is pending, the general idea being that until appeals within the administrative agency are exhausted, there is no final administrative decision requiring the taxpayer to pay the tax.

47. To the extent that the system allows deferral of payment during the appeal process, it tends to encourage litigation. This should be kept in mind in designing the rule specifying to what extent deferral is allowed. Another aspect would be to review the general approach for payment arrangements for taxpayers having cash-flow difficulties. Adopting a flexible approach in agreeing to payment arrangements with taxpayers may also reduce litigation that is motivated primarily by a need to defer having to make immediate payment.

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\(^2\) As an example, U.S. taxpayers can lodge their cases in the Tax Court without paying the tax. See I.R.C. sec. 6213.

\(^3\) See Victor Thuronyi, Comparative Tax Law (Kluwer Law International, 2003) at 218 n. 41. In Germany, as a rule, appeals procedures do not suspend tax collection. See par. 361 AO (German General Tax Law).
48. Some countries have had a rule that if the taxpayer does not pay the tax the protest/appeal will not be accepted. This is a harsh approach and may raise constitutional questions of due process or procedural equality before the law. A more moderate alternative is to provide that the failure to pay the tax does not affect the taxpayer’s right to have the appeal heard, but the taxpayer will be subject to the compulsory collection procedure in the event that no deferral of payment is authorised and the taxpayer fails to pay.

49. In any system where the payment obligation is suspended on appeal, when the taxpayer agrees in part with the tax assessed, the amount not in dispute should be paid following the normal collection procedure independently of the protest/appeal.

50. In cases where a protest/appeal suspends the collection of the tax, the law should allow the tax administration to take preventive measures (such as freezing assets), to ensure that the taxpayer pays the tax.

51. Some countries require a partial payment of the tax assessed as a precondition to challenging it. Although this rule could be acceptable, care must be taken that the rule not exclude from judicial protection taxpayers without the needed economic means. There should always be a possibility for the taxpayer to petition the court to suspend the requirement to pay the tax.

52. An intermediate possibility would be to require the tax to be paid, but only after the ruling of the lower-instance court. To the extent that the lower-instance court has approved the tax assessment, the taxpayer is being made to pay not just an amount that has been asserted by the tax administration, but an amount that has been independently confirmed as legally correct. A rule requiring payment of the tax before an appeal can be lodged might be appropriate in countries suffering from a particularly high rate of appeals from lower-court rulings in tax cases.

53. In systems requiring payment, the payment requirement might be automatically suspended when the taxpayer presents the guarantee of a financial institution that will pay the tax in case the taxpayer does not. This guarantee, together with the accrual of interest, gives flexibility to taxpayers and security to the tax administration. When the taxpayer neither pays the tax nor offers a guarantee, the tax authorities should, in principle, have the right to pursue compulsory collection, parallel to the ongoing protest/appeals procedure, unless the court approves suspension of payment. Two safeguards should be considered: 1) the person considering the protest/appeal should be able to stop the compulsory collection procedure if the taxpayer appears to have a strong case on the merits; 2) no drastic measures (such as selling important business assets or the taxpayer's home) should be taken until the final resolution of the case.

**Payment of interest**

54. If the tax is not paid before the protest/appeals procedure, the question arises as to whether the taxpayer has to pay interest on the amount due.

55. Allowing taxpayers to challenge tax assessments without paying the tax and without interest accruing is unfair to taxpayers who have paid their liability on time, and fosters
litigation. Therefore, this possibility should be excluded. After the court confirms the tax assessed by the tax administration, interest should accrue from the original due date for the tax until it is actually paid.

56. On the other hand, when protest/appeals procedures do not suspend the collection of the tax, and it is paid, and the assessment is subsequently reversed by the court, the tax paid should be refunded to the taxpayer, together with interest from the time of payment until the time of the refund. Although the payment of interest involves a cost for the budget, any other approach would be unfair.

57. This poses two different questions: 1) what is the appropriate rate of interest?; 2) must the same rate of interest apply for taxpayers and tax administration?

58. Applying the same interest rate can be defended on the basis of equal footing and the fact that, in principle, interest is only a measure of time value for money which is the same whoever the debtor might be. This approach is also simpler.

59. On the other hand, the positions of taxpayers and tax administration are not necessarily equal (for example, taxpayers would pose a higher credit risk than the government) and there should be no serious constitutional obstacles to a reasonable difference in the rate of interest.

60. Whatever position is taken, the rate of interest should be reasonable, taking the market into account. When the interest charged is excessive, the result tends to be an accumulation of arrears, many of which in practice are not going to be collectible. An excessive level may also lead taxpayers to contest tax assessments just because they cannot pay the fines and interest. An excessive rate in favor of the taxpayer can offer windfalls to smart taxpayers who might try to manipulate the system. The law should provide for a floating rate of interest, since otherwise the rate specified will eventually end up being too high or too low, as economic circumstances change.

61. In some counties, interest on fines is not allowed, by law or by judicial interpretation. The general practice of the system should be taken into account while making a decision on this topic. If interest is not charged on fines, tax payments should be allocated first against any fines outstanding, before being allocated to outstanding amounts of tax.

62. One reason that interest is not charged on penalties is that the time the penalty arises is somewhat arbitrary. On the other hand, in the case where the penalty reflects behavior on the tax return and represents a percentage of tax due (as in the case of an understatement penalty) it seems reasonable to treat the penalty in effect as part of the tax and as subject to interest in the same way as the tax itself.

The burden of proof

63. The burden of proving that a tax assessment is incorrect tends to be placed fairly squarely on the taxpayer in common law countries, but in some cases is shifted to the tax authorities. In civil law countries the allocation of the burden tends to be more complex, and
to be based on both general principles of civil procedure and specific provisions in the tax laws.\textsuperscript{4}

64. In common law countries, the tax audit process tends to be informal, in the sense that there is not an emphasis on formal findings of fact. Of course, the auditor must base the assessments on facts, but these do not have to be validated by evidence, such as the recorded statements of witnesses. If formal fact finding is required, this is typically left to a later stage (the judiciary).

65. By contrast, civil law countries tend to take a more formal approach to audits, requiring the auditor to gather evidence in a more formal way, by way of authenticated documents, statements of witnesses, and the like. The audit process therefore ends up finding the facts, and this fact-finding (unless timely disputed by the taxpayer) ends up bearing a presumption of correctness.

66. For civil law countries, some previous considerations have to be taken into account in order to formulate rules on the burden of proof in protest/appeal procedures:

1. The burden of proof has to do with facts and not with legal rules.

2. It is a general rule in most legal systems, that in a proceeding each party has the burden of proving what is in its interest.

3. On the other hand, there is a presumption of legitimacy of administrative decisions.

4. It is also a general principle that the courts have to evaluate the evidence freely and in good conscience, meaning that legal rules of proof tend to be applied flexibly.

5. The facts to be considered for a tax assessment are normally in the hands of the taxpayer, which imposes on the taxpayer a special burden.

6. These facts are numerous, complex, and extensively connected with legal qualifications, which means that often they cannot be properly analyzed in an appeal procedure, but need to be fixed in advance. This is the role of the audit procedure in many countries: to verify facts, analyzing them from the tax law point of view, and find the facts. This should imply a sort of presumption of the facts found by the tax auditor.

7. This means that mechanisms must be put in place to make sure that the facts are accurately determined in the audit procedure so that they can be considered as proven. There are two important tools for that purpose: i) adequate regulation of the factual verification and documentation in the audit procedure, imposing on the auditor the obligation to carefully document the relevant facts, ii) asking the taxpayer to express the taxpayer's view on the facts as described by the auditor, in which case this could be considered as the taxpayer's admission on the relevant facts.

\textsuperscript{4} See Thuronyi, supra note 4, at 218-19.
8. The facts declared by the tax auditor in the audit documentation as verified should, in principle, not be subject to much doubt. The same should apply to the facts recognized by the taxpayer. When both are coincident, no problem of proof should arise in the appeals procedure. When they are not coincident they have to be analyzed by the protest/appeals body. In this case, the above presumption should be taken seriously, meaning that, although it should not be irrebuttable, overcoming it should not be too easy.

9. The principle of good faith prevents anyone from turning against their own actions; it could impose limitations on the taxpayer changing the taxpayer’s previous declaration about the factual situation.

10. On the other hand, according to the principle of legality, taxation is imposed on real situations as they are considered in the law. This imposes on the tax administration the burden of proving the facts on which it bases its decision. This is not a question of burden of proof, but is inherently connected with the logical application of the law to the situation foreseen by it.

67. Taking into account all these sometimes contradictory considerations, the following can be said (primarily in relation to civil law countries):

1. Once the taxpayer has submitted a tax return, if the tax administration intends to make a decision that departs from it, the taxpayer must be given the chance to defend the correctness of the return, delivering the necessary accounts, documents, and explanations. To the extent the taxpayer does not succeed, the tax administration has the right to amend the assessment of tax as shown on the return.

2. But in doing so, the tax administration has to base its decision on a factual situation that has to be proven, being obliged (at least where the audit process is a relatively formal one) to deliver the corresponding proof.

3. When the tax administration has to make the decision to consider some facts as proven, its approach to fact-finding should be guided by how courts apply rules of evidence, given that administrative decisions are subject to judicial control.

4. Once the tax auditor has verified a fact, this has to be accepted as such unless the tax auditor’s credibility is seriously challenged. This imposes on the tax auditor the obligation to take special documentation measures and to discuss the facts with the taxpayer.

5. The facts verified by the tax auditor can differ from the facts declared on the return. If the taxpayer wants to change the taxpayer’s previous representation of facts, this should be allowed during the audit procedure. (Of course there might be a penalty if the taxpayer admits a misstatement of facts on the return.) After the audit is finished the taxpayer should not be allowed to change the taxpayer's representation of the facts, the reason for this being the principles of good faith and procedural appropriateness, at least in countries where after the audit procedure there is not a proper forum to verify facts.
6. Further judicial instances can analyze the evidence collected in the audit procedure which is under dispute. These instances do not make new verifications, unless the tax auditor did not allow the taxpayer to present evidence that was timely offered during the procedure or was not available for justified reasons.

7. Each procedural stage plays a role; after the audit procedure no new evidence should be accepted without justification for the lack of timely presentation. This is a question of procedural good faith. If there is not a clear rule in the system requiring the taxpayer to present evidence during the audit process, the system will tend to litigation as the taxpayer will always have the chance to present new evidence that could favor the taxpayer without this evidence being properly verified by the tax administration.

8. Disputing facts in the protest/appeals procedure before the tax administration should be avoided where possible. Differently from the audit function, Appeals is not set up to investigate facts. In case facts need to be found, it would be advisable to try to reach agreement on facts between the taxpayer and the appeals office. Such an agreement would come to the judiciary as proven.

9. The judge in the pre-trial phase could also play a relevant role as mediator to settle facts. If facts are not duly documented by audit, and agreement on the facts is not reached, they will have to be proven by the interested party before the court.

Scope of review

68. The question arises as to what extent the reviewing body can substitute its own rationale for the reviewed one or is its control limited to reviewing errors made below.

69. The solution taken on this point can avoid or lead to litigation. If the courts can freely substitute their own rationale the system will tend to litigation.

70. On the other hand, the courts have the last word on the application of the law.

71. This means that two different kinds of administrative actions have to be differentiated: actions strictly subject to rules and actions where some discretion is allowed to the tax administration. This discretion can be expressly awarded by the law or can derive from the factual situation in cases where some human evaluation is needed, which is often the case in taxation.

72. In these cases it does not make sense that the courts substitute their own rationale. Discretion awarded to the tax administration must be respected by the court. When the tax administration has authority to exercise discretion, the court’s role is to control that the discretion is exercised in a reasonable, not arbitrary way and according to the applicable rules.

73. When no discretion is allowed to the tax administration, the court controls the whole scope of the case, making its own decision on the right legal treatment for it.
74. The question here is the scope of the court’s review of previous judicial instances: whether further instances are free to substitute their views on facts and law or are limited to review errors made by previous judicial instances. The answer to this question depends on the judicial system and the legal culture of the country. While further instances may have a clear role in deciding what the law is, the review of the facts previously considered proven by judicial instances is generally limited. Second instances are in general not considered appropriate to deal with evidence, as they tend to be more formal and removed from the case. In principle, the first judicial consideration of the evidence tends to be considered the most appropriate; as the role of the second instance related to facts is restricted to control that no clear error in the evaluation of the evidence has been made.

75. A different question is whether the scope of review is restricted to the problems posed by the taxpayer or allows the protest/appeal body to go beyond the parties’ argumentation and take into consideration legal reasons not alleged by the parties. In principle, as the obligation of the tax administration is to apply the law in an impartial manner, independent of the cleverness of the taxpayers or their advisors, in the procedure within the tax administration the rule should be to analyze all aspects of the protest.

76. The opposite rule should perhaps apply in the third party or judicial review as it cannot have all the relevant information needed to go beyond the parties’ petition. Again, this will depend on general practice in the country's judicial system.

The effects of administrative silence

77. Each step in a protest/appeal system typically involves a deadline.

78. This poses the question of what happens if the protest/appeal authority does not make its decision by the stipulated deadline. The options are to consider the taxpayer's appeal to be automatically accepted or rejected in this case.

79. If the appeal is treated as automatically rejected, the taxpayer is entitled to go to the next stage to challenge this silent decision. This option is clearly preferred, as silent acceptance of taxpayers’ protest/appeals could lead to an unduly hasty rejection of the appeal in a complex case where a considered decision cannot be taken in time or, if appeals are not properly kept track of, to cases where appeals are automatically accepted by mistake (or corruption).

80. When the rule of negative silence (deemed rejection of the appeal) is in place, special attention has to be paid to the possible existence in the administrative law system of a general rule according to which the administration must answer every citizen request. Such a rule

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5 In the U.S., for instance, there is a debate over deferential review versus de novo review, the first meaning that the Courts of Appeals respect Tax Court rulings, so far as they are not flawed. Deferential review could be advisable when the lower court is a more specialized one than the appeals court. See Andre L. Smith, “Deferential Review of Tax Court Decisions of LW: Promoting Expertise, Uniformity, and Impartiality”, 58 Tax Law. 361. From the point of view of reducing litigation, deferential review is advisable too.
implies that, even after a negative silent decision, an express decision must be made and communicated to the taxpayer. The relationship between both decisions (silent and express), on the same case and with possible contradictory content, should be clarified. Only one protest/appeal procedure should be followed for each case, which means that an appropriate way to merge both possible decisions must be articulated.

81. The taxpayer may be content to await the express administrative decision, without immediately appealing to the next level. In these cases, the question arises as to what happens when the body in charge of deciding the protest delays further in issuing an express decision.

82. Setting a defined deadline to file the next protest/appeal after the silent rejection of the first, would force the taxpayer to go to the next stage, while the case might still be resolved in the first one. The rule that while there is no express decision the deadline to appeal to the next stage does not lapse solves this problem and at the same time gives the taxpayer the possibility to wait as long as the taxpayer considers appropriate, filing the new appeal only when the taxpayer is no longer willing to continue waiting for the express rejection of the first one.6

**Representation of the parties**

83. The taxpayer must have the right to be represented or assisted by a tax advisor or a lawyer during the protest/appeals procedure.

84. Is the taxpayer obliged to have a representative? A representative should not be needed in the administrative procedures which should be free of charge and with as little extra cost as possible.

85. As for judicial procedure, in many countries the taxpayer needs a lawyer while in some others a tax advisor can defend the taxpayer's case before the tax court.

86. If the judicial process becomes more expensive, the volume of litigation will be reduced. But to what extent is tax representation in court needed? In case of a flexible judicial review with pre-trial oral proceedings, the possibility of the taxpayer defending him/herself could be considered.

87. In some countries, e.g., Spain, the administration has a general legal service, which can be in charge of tax matters as well, while in some other countries (e.g., the U.S.7), it is the Treasury/Ministry of Finance who has a specialized body of tax lawyers to represent the tax administration before the judiciary. In some other countries, as in Germany, it is usually the

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6 If the appeals official considers that the time available to resolve the appeal is not enough, he/she could informally communicate with the taxpayer to let the taxpayer know that more time is needed for the express decision.

7 In the U.S., IRS attorneys represent the government in the Tax Court, while specialized Justice Department attorneys represent the U.S. in tax cases in the courts of general jurisdiction.
same civil servant who dealt with the case in the appeals office who represents and defends the tax administration's position.

88. It is preferable for specialized lawyers to defend the tax administration in complicated tax cases. Also the appeals officials should have adequate expertise to defend the case before the court. They are legally allowed to do so in Germany, with a very high level of success.

**The prohibition of “reformatio in peius”**

89. This rule prohibits that in a protest/appeal procedure the situation of the citizen be worsened in comparison with the decision being appealed from. Although in some countries the rule is considered an important administrative law principle, in some others, e.g., the U.S. and Germany, there is no such rule.\(^8\)

90. The rationale of this rule is clear: it intends to protect citizens against actions by the authorities in revenge for the filing of a complaint.

91. On the other hand, this rule tends to encourage litigation. (The taxpayer knows that litigation cannot result in an increased assessment. The tax administration might be encouraged to maintain a high assessment until a judicial appeal is filed, and such an excessively high assessment in turn invites litigation by the taxpayer.) The decision on this rule should consider the factual situation of the country and its legal system as well.

**Penalties for frivolous appeals and reimbursement of litigation costs to prevailing taxpayers**

92. The law could penalize frivolous appeals. The taxpayer could also be required to pay the costs of the procedure. Both of these rules can be found in different countries, often with discretion on the part of the judiciary in implementing them.

93. The problem with rules of this kind is that, if not properly managed, they can excessively discourage taxpayers from challenging unfair administrative decisions.

94. An analogous rule is foreseen in some countries for cases where the behavior of the tax administration is considered by the court not only incorrect but also unreasonable. In this case, the court might be allowed to order the tax administration to reimburse the taxpayer for the cost of the appeal. This rule applies in some countries in all cases in which the tax administration decision is reversed by the Court. In the U.S. the taxpayer is entitled to receive reasonable litigation costs when the taxpayer is the prevailing party, unless the position of the tax administration is substantially justified. To qualify for this, the taxpayer must exhaust all administrative remedies.\(^9\) As this rule poses budget risks, it has to be considered carefully. Paradoxically, a rule allowing the taxpayer to recover the costs of

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\(^8\) For instance, in Spain, articles 223 and 237 of the General Tax Law (Ley 58/2003, of 17th December) establish that rule, whereas par. 367.2 AO (Germany) and I.R.C. sec. 6214 (a) expressly exclude it.

\(^9\) See I.R.C. sec. 7430. A partially similar rule can be found in Spain. See art. 34.c) Ley General Tributaria.
successful litigation might reduce the amount of litigation. While such a rule encourages taxpayers with strong cases to pursue appeals, it could have the effect of discouraging the tax administration from overly aggressive assessments (or at least from refusing to concede the case at the appeals stage). As a result, the overall number of cases reaching the courts might be reduced.

95. While these rules may play a role in respect to judicial appeals, they are clearly not advisable for protests within the tax administration, as the possibility of internal review should not be restrained and no cost should be incurred by the taxpayer.

V. ORGANIZATION OF AN EFFICIENT PROTEST/APPEALS SYSTEM

96. Tax disputes can be resolved by two different paths: by way of protest/appeals systems or by way of ADR systems. They are different but can be connected, as discussed below.

97. The possible ways to protest/appeal are the following:

1. Protest within the tax administration.

2. Protest/appeal to special bodies/committees, inside or outside the tax administration, belonging to the executive branch, not to the judiciary.

3. Appeals to the court.

98. While the first should exist according to best practice and the second is possible (advisable or not depending on the country), in many countries the third option for the taxpayer is constitutionally required.

99. The question arises as to whether these ways are alternative, simultaneous, or consecutive. This also could be partially or totally left to the taxpayer’s choice, as happens in some countries.

100. Best practice advises protests before the tax administration to be a pre-requisite to appeal before the court. The main reason for this is efficiency, as the vast majority of cases can be disposed of at the administrative level.

101. When there are administrative appeal committees the question is whether they are a pre-requisite to appeal before the court or are optional. There is no definitive answer to this question as it will depend on the country.

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10 This is not the case in the U.S., where taxpayers may lodge their complaint directly with the courts. But in this case the prevailing taxpayer will not be entitled to recover litigation costs. In Germany, Spain, Italy, and many civil law countries legal remedies before the tax administration have to be exhausted before going to court.
102. In several countries no general unified protest/appeals system for all tax matters is in place. On the contrary, the system often depends on the tax involved, and, sometimes, on the type of decision. However, best practice is that the protest/appeals system be the same for all taxes.

A. Steps in the protest/appeals procedure

103. We use the terms administrative protest and judicial appeal. A reasonable protest/appeals mechanism could have the following steps:

Protest within the tax administration

104. Best practice is to have within the tax administration a quasi-independent appeals office which has the authority to settle cases on the basis of the hazards of litigation. If such a system is in place and functioning, the vast majority of cases can be settled before they go to court.

105. Therefore, the first step in the system should be the protest within the tax administration, as this is the speediest and least expensive way for taxpayers, at the same time giving the tax administration the opportunity to review its decision and correct possible mistakes. This procedure should be free of charge and without the taxpayer needing a representative or tax advisor.

106. The protest procedure should be flexible, informal, and quick (the law should specify a deadline by which the protest must be filed). If this deadline elapses without the taxpayer lodging a protest, no further complaint should be possible.

107. The taxpayer should have the possibility of personally discussing the case with the appeals official, who should try to understand the taxpayer's position, avoiding litigation so far as this is reasonable and an agreement can be reached. If an agreement extends to facts and law, the case should be settled. If this is not possible, an agreement on facts should be possible if the audit section did a reasonable verification work. In other cases, the appeals section should analyze the facts, trying to agree on them with the taxpayer and, if not possible, to document them sufficiently. The attitude towards evidence should be flexible. The idea is to allow the taxpayer to prove facts by any reasonable means, not to require strict adherence to rules of evidence (unless there is a suspicion that the taxpayer is dishonest and

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11 Different terms are used in different countries. “Protest” is often used for complaints before the tax administration, whereas “appeal” often refers to court procedures. In some countries, “appeals” refer also to administrative procedures, while judicial review of tax administration decisions may be referred to as litigation.

12 Jurisdictions differ in respect of their legislative environment, administrative practices, and culture. This note should be read with this in mind. Care should be taken when considering a country’s system to fully appreciate the complex factors that might shape a particular approach. The development level of the country, in this respect, plays a paramount role.

13 See Thuronyi, supra note 4, at 218.
is actually fabricating evidence). More broadly, the appeals discussion should be based on arriving at an amount of tax that reasonably reflects the application of the tax law to the facts of the taxpayer, rather than making sure that every deduction claimed by the taxpayer is completely documented according to applicable rules and every item calculated exactly as the applicable regulations require. In other words, there should not be an attempt on the part of the tax administration to be as strict as possible. If this approach is followed, both on audit and on protests, there will be fewer disputes and disputes will be resolved more expeditiously.

108. The appeals officials should pursue the public interest in the correct application of tax law and not the collection interest of the tax administration, having the obligation to objectively analyze the taxpayer’s case.

109. The question is what is the right office to be in charge of this procedure, whether this should be part of the normal organization of the tax administration or a separate office.

110. In some countries there is no special appeals/protest office within the tax administration, the same section which made the decision being in charge of analyzing the protest. Obviously this is not the best way to avoid litigation. On the other hand, there can be benefits from giving the decisionmaker an opportunity to consider the case afresh. One way of doing this is to follow the practice of some countries in including an informal appeals step before the assessment is formally issued, as discussed above (para. 23).

111. Often the most efficient solution is to set up a separate appeals office within the tax administration. Although this might lack the appearance of impartiality, this is the most cost effective solution. An effort should be made to assure effective independence, and if this is done this will before too long become known to taxpayers.

112. The territorial organization of the appeals office could depend on the territorial organization of the tax administration, its size, personnel and material resources, as well as on cultural and historical factors.

113. The ideal appeals office could, in principle, mirror the rest of the organization of the tax administration. This means that at the territorial (local or regional) and central levels where the decision making tax offices are located, an appeals office could also exist, at the same organizational level (or a higher one, never at a lower level) as the audit section, in charge of resolving disputes related to the decisions of the tax office where they belong.

114. In a typical tax administration structured at a local, regional, and central level (the last normally for large taxpayers) there could be appeals offices at each of these levels.

115. These offices should ideally be organizationally and practically independent of the offices whose decisions they review. Alternatively, an acceptable level of independence could be achieved. For this reason, the manager of the appeals office should ideally not have any hierarchical relationship with the decision making managers or be subject to any type of instructions by them, and should be subordinate directly to the head of the office or a third authority (for example, a national appeals office).
116. Independence can also be fostered by transparent selection procedures for the staff (vacancies should be advertised), which should be highly specialized (there must be minimum qualification criteria). The appeals officials should be tax officials with previous audit experience and good legal education.

117. Another measure which can support independence is a certain degree of security of tenure awarded to the staff. This can be underpinned by means of a fixed term and/or a prescribed procedure for removing them from office.

118. A model for this type of office could be the German appeals offices located in most of the tax administration offices. As with other aspects of the dispute resolution system in Germany, this organizational model has a downside in terms of the resources needed, and therefore is unlikely to be implemented elsewhere in the same way as in Germany. It can be efficient for a tax administration dealing with a large number of cases, but needs a high degree of specialized personnel, thus being appropriate for countries with a certain level of development. As in Germany, appeals for taxes requiring specialized knowledge or involving a low volume of appeals could be handled differently from an organizational point of view.

119. In developing countries, lack of specialization can be a problem. The availability of human resources must, therefore, be taken into account when designing the organization of the appeals office. If there is a lack of specialized personnel a more modest and centralized system could be established. In this case, depending on the availability of adequate human resources, the appeals offices could be located at regional or central level (or could be only a central office).

120. The more centralized the system, the more attention should be paid in terms of allowing the best possible communication with taxpayers, who should not need to make considerable travel arrangements to have access to the office. In this case, the use of telephone, e-mails, or whatever technical means available is a must. Also the possibility of the appeals officials to travel to the taxpayer’s location could be considered (typically they would then consider at the same time a number of cases in the same city or region). Of course this involves a cost that would need to be budgeted for, but could be more efficient than requiring a number of taxpayers to travel.

121. Appeals officers normally work on an individual basis on the assigned cases. For efficiency reasons, it is not advisable for appeals officers to work on cases as a committee. (This does not mean that staff should not meet periodically to discuss technical problems and undergo training.) In countries without enough specialized and capable personnel, the possibility of committee work could be considered, as this could allow less trained personnel to take advantage of more experienced colleagues, hence, increasing the quality of the work.

122. A different possibility in case of scarce expertise could be that all decentralized appeals offices be hierarchically connected to a central appeals office in charge of giving advice and solving more complicated technical topics. A second level of review could be established within this central office.
123. All these different possibilities can be utilized, together or separately, to a different degree depending on the situation of the country.

B. Protest/appeals before quasi-judicial administrative bodies

124. A possible second level in the system could be the complaint before an administrative court (court-like body/special administrative committee within or outside the tax administration), functioning independently from the revenue agency.

125. If the appeals section within the tax administration is well functioning, best practice advises establishing it as a first mandatory step.

126. Committees are not an efficient way of solving problems on a day to day basis, they are expensive to maintain, and their procedures tend to be lengthy. As they do not belong to the judiciary they cannot play the role of completely guaranteeing the protection of taxpayer rights, since their decisions can be appealed before the judiciary. As a result, they add a new lengthy step to the procedure without definitively solving the dispute in most cases. However, they can be useful if the alternative of appeal directly to court is problematic. Ideally, the best approach is to fix the court system, but this may be difficult and take time. It may be easier to establish a specialized tax appeal tribunal.

127. These committees can also function as the first step in the protest/appeal procedure if the special protest/appeal office within the tax administration as above mentioned is not in place.

128. When the number of disputes is high, this choice may not be advisable. However, there might be concrete historical, sociological, cultural, or psychological reasons advocating for these types of administrative courts. As they are independent of the “normal” tax administration, they could be advisable in cases where the latter lacks prestige among taxpayers so that an independent instance is needed to review cases prior to litigation.

129. A case for such a quasi-judicial body could also be the one analyzed above, where the lack of expertise in countries without an excessive number of cases could lead to a rather centralized scheme with one or several administrative “courts” working in a hierarchical way as one of them might be in charge of reviewing all or some of the cases of the others or of giving some advice or instructions to them.

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14 In some developed countries, these administrative “courts” developed as specialized tribunals fully integrated into the judiciary. This is the case in Germany, where in 1968 the administrative courts developed to the Finanzgerichtbarkeit (specialized tax courts) and in Canada, which in 1983 created the (judicial) Tax Court instead of the previous administrative Tax Board.

15 As these bodies/committees are not part of the judiciary they are public administration. As they deal with tax matters they are tax administration. What matters is that they have a real and apparent independence from the tax administration whose decisions are being reviewed.
130. In some countries these administrative courts are organized in two levels. This is costly, lengthy and does not add any significant value, thus not being, in principle, advisable, unless the lack of expertise at the lower level advises otherwise.

131. These quasi-judicial bodies can also function as an alternative to the protest before the appeals section when it exists but is not properly functioning (because it lacks sufficient independence, is not well staffed, its decisions are technically deficient or not on time). If this is the case, focusing interest and scarce resources on improving the functioning of the appeals section within the tax administration is normally the most efficient way to address the problem.

132. These quasi-judicial bodies can play a relevant role if they: i) are well organized (well staffed with appropriate expertise) ii) function independently from the tax administration (and at a level higher than the authorities under review), iii) are free of charge, and iv) enjoy enough prestige so that most cases do not go on to judicial review after their adjudication.

**Appeals before the court**

133. After protesting to the tax administration or to the quasi-judicial committees mentioned above, the taxpayer can still disagree with the result, in which case the taxpayer can appeal before the courts. An excessive volume of appeals to court can be due to rules concerning deferral of payment and interest (discussed above), as well as a deficient functioning of the administrative appeals process. A well functioning appeals process should resolve virtually all disputes before they get to the courts.

134. Appeals before the courts are the last step in the procedure. They can be in one or two levels, in which case the first judicial decision can be appealed before the second judicial instance.

135. Normally, the number of courts that one can appeal to (one, two, or even three levels) depends on the general organisation of the judicial system (or in some countries the organisation of appeals from administrative agencies), although there may be special rules for tax.

136. The second level of appeal, if there is one, should in general not enter into the facts of the case, being restricted to legal questions. Whether the case is subject or not to review by the higher judicial level may be a decision to be made by the court at the first level of judicial

\[16\text{Notwithstanding the always open possibility for the Appeals Court of correcting obvious errors or mistakes committed in the evaluation of the evidence by the previous judicial instance.}\]
review, as is the case in Germany, or can be a decision of the higher level court, as is the case with the U.S. Supreme Court.\(^\text{17}\)

137. The judicial review of tax disputes should be a normal part of the judicial system with as little organizational and procedural divergences from normal procedural rules as needed. Nevertheless some peculiarities should be considered.

**The needed specialization of tax courts**

*a. Organisation and training*

138. The most important question in designing a system of appeals before the courts is what type of court should be in charge. There are three possibilities:

1. The general courts are in charge of reviewing tax cases.

2. General courts with specialized chambers are in charge.

3. There are courts specialized in taxation.

139. The last solution tends to be the best, although it can be approximated by option 2 if this is well designed. Tax cases are often complex and when the general courts have to deal with them at least two problems appear: i) general courts cannot specialize in tax questions, so their decisions have little chance to be technically sound, ii) courts tend to avoid dealing with tax cases, leaving them for a later moment, thereby leading to backlogs. Even within taxation, specialization of judges can be desirable, and some countries have opted for this (e.g. one specialized court or chamber for income tax and another for VAT).

140. If special chambers for tax cases are established within the general courts, the arrangement will be most effective if specialized judges are appointed to these chambers. A specialized chamber constituted by judges without prior specialized experience can learn how to deal with tax cases by practice, but it is better for judges to already have tax experience upon appointment.

141. The use of specialized chambers is not a solution that is unique for taxation. A similar approach has been taken by a number of countries in order to promote specialization within the judiciary that can lead to more competent decisionmaking and quicker decisions. One implication of this approach is that it works best with larger courts, which may involve closing and consolidating existing smaller courts.

142. Lack of knowledge on the part of the judiciary produces results that can be contradictory and unfair: sometimes judges have the attitude of taxpayers confronting the tax administration independent of the merits of the case they are judging and sometimes they

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\(^{17}\) This is a country-specific issue which depends on the organization of the judiciary, generally not involving special rules for taxes.
blindly trust the tax administration as they cannot understand what the problem is about. Both types of behavior undermine the foundations of the rule of law.

143. The best way to confront this problem is having specialized tax courts as a specialized judicial line within the judiciary. Specialized judicial line means all courts dealing with tax matters belong to it, including both the first and second levels of judicial review. The most general and advisable organization is the existence of several courts at first territorial level, dealing with the cases in their respective territory, and a central court for appeals.\(^\text{18}\)

144. Specialized tax courts pose the question of how to properly staff them. Tax court judges should have previous tax experience as lawyers either in the tax administration or in the private sector. Bias can be avoided by means of reasonable selection criteria and independence in function without an easy way back to the tax administration or private practice.

145. A model for this choice could be Germany, where the judges of the tax courts often come from the tax administration. As they are selected on the basis of their legal knowledge, and have an independent status, they are soon detached enough from the tax administration, so that no bias can be found.

\textbf{b. Procedure}

146. Appeals before the judiciary could be before a bench (e.g., a three-judge bench) or before individual judges. Independent of the formal decision made, as for traditional organizational reasons a bench and not individual judges could be in place, individual judges should generally be assigned specific cases to solve, which could be discussed in court in case the judge does not succeed in getting the parties together to a common understanding.

147. A related question is whether the procedure is written or oral.

148. If the judges generally lack experience and knowledge, written procedure and bench work could be advisable, as this may guarantee a deeper consideration of the case and a better quality. When the judges are experienced and knowledgeable, oral procedure directed by the judge and with quite free intervention of both sides (taxpayer and tax administration) is advisable as this speeds the procedure. In this case, the judge could play a relevant role as mediator/conciliator.

149. A good model for this could be the German system\(^\text{19}\) where a specific judge is responsible for each case. The judge convenes the parties to a pre-trial hearing where each party presents its view. As an experienced tax professional, the judge tries to convince the

\(^{18}\) This is different from the U.S. system where the first level of review by the Tax Court is specialized, and consists of only one court, while the Courts of Appeals are several and not specialized.

\(^{19}\) Germany has a specialized system of tax courts where the judges are tax specialists who play a significant role in the litigation procedure finding the facts of the case and trying to get the parties to reach an agreement on a reasonable solution of the case.
parties to find a reasonable solution, letting them know what the judicial decision could be otherwise. Most cases are resolved this way. If an agreement is reached, the judge drafts the minutes of the agreement and the tax administration issues the new assessment when needed.

150. A special procedure for small tax cases makes the judicial system accessible to all, but also allows small cases to be dealt with expeditiously. Court systems generally may have procedures for small claims, and special procedures for small tax cases can follow an analogous approach.

C. Possible decisions in the protest/appeal procedure

151. The decision made in every step of the protest/appeal procedure can be:

- To totally deny the protest/appeal, and uphold the decision.
- To accept the protest/appeal while cancelling the decision with or without the possibility for a new decision on the case.
- To partially accept and deny, issuing a new assessment, order to refund, or penalty.

152. In the first case, the procedure to collect the tax liability confirmed will start if it has not yet been paid. If the taxpayer had previously paid only a part of the assessment, then the difference must be paid. This has to be done within a reasonable time, usually about one month from the date of notification of the adjudication, if not sooner.

153. Sometimes, after nullifying the administrative decision there is the possibility of the tax administration going back to the case and making a new decision. The problems that might arise are similar to those arising in the third case.

154. In the third case, after the administrative assessment is nullified or cancelled in the protest/appeals procedure, a new determination of the tax liability or refund, together with any penalty and interest, is needed.

155. The question arises as to who is in charge of issuing the new decision, whether the tax administration or the protest/appeals instance. That is the question as to whether the decision of the protest/appeal instance must contain the new decision needed to substitute for the reversed one.

156. Efficiency reasons advise that the administrative instance knowing the protest/appeal include in its decision the new assessment, refund, or penalty.

157. Issuing a new assessment when a previous one has been declared incorrect is not always easy and depends on the exact terms of the decision. Charging the protest/appeal instance with the new assessment when this is possible forces it to enter into the details of the case.

158. However, in cases where the facts are considered insufficiently clear, yet susceptible of further verification by the competent section of the tax administration (often the audit
section) or an important procedural error has been made, which can be repaired, the review instance cannot formulate the new decision needed after nullifying the previous one. This is often the case when a judicial review has taken place, which does not uphold the challenged decision.

159. Due care must be taken while providing for this possibility. In some countries it can be a substantial reason in its own right for backlogs of cases in dispute. It is not unusual for the tax administration to replace a decision that has been cancelled with a new one that is virtually identical.

160. Although the possibility of the tax administration making mistakes and correcting them as a result of the protest/appeals procedure, thus going back to the case to do things in a better way has to be acceptable, limits need to be put in place on the possibility of revisiting the same case several times. Without such a limitation the tax administration may try to revisit the same case several times without a serious intent to deal with it in a proper way. The problem can be minimized when the review body gives specific instructions to the revenue authority as to how to deal with the case in the new decision to be made.

161. However, in these cases the problem is that the new assessment issued could also, in principle, be protested/appealed following the same procedure as was followed for the previous decision. This could keep the case open for too long a time and makes no sense.

162. Therefore, the right solution for these cases could be to treat them as incidental to the implementation of the first decision to be analyzed directly by the review body which made it and not as a new independent case for protest/appeal, thus sparing resources and maintaining control on the case at the same time, making sure that the new decision follows the instructions issued by the reviewing body.

D. Implementation of the decision made in the protest/appeal procedure

163. A decision has to be made as to the right moment to implement the decisions made in the course of the protest/appeal procedure, and clear rules should be in place for this. As decisions along the way may change, it is advisable not to change the previous decision until the final step when the case cannot be appealed further. A different solution will pose complex practical problems as decisions can change in different details in the course of a proceeding.

164. The functioning of the statute of limitations has to be taken into account, so that it does not impede implementation of the final decision.
VI. ALTERNATIVE DISPUTE RESOLUTION

A. ADR

165. In a broad sense, ADR can refer to ways of solving disputes different from litigation. In that sense, even protest/appeals systems within the tax administration (discussed above) could be considered ADR. Typically, however, ADR refers to an alternative way of solving disputes, which differs from the traditional protest/appeals mechanisms and involves negotiation.

166. HMRC puts it this way: “Traditionally tax disputes are settled either by litigation or, in the majority of cases, by out-of-court agreement following discussions between the two parties. The essence of ADR is that a third party is brought in with the agreement of both parties, either to determine the dispute (arbitration) or to facilitate bilateral agreement (as an expert, or through mediation).”

B. The recent trend toward ADR

167. The general trend is toward more widespread adoption of ADR, although approaches vary from country to country and are at different stages of development. One motivation for ADR is to deal with a heavy caseload of appeals. ADR can involve procedures that are more flexible and less burdensome for the taxpayer as well as being more cost effective for the tax administration.

168. The main concerns relating to ADR are the principles of legality and equality of taxation. Care must be taken that ADR not undermine the rule of law, or deal with issues that are not capable of settlement, for instance, cases where the law is clear, or alter the powers and responsibilities of administrative bodies. ADR must be designed to work better and more swiftly in the public interest and not become a channel for relaxing compliance with the law.

169. Not all administrative activity is stringently predetermined by laws, nor does the administrative function simply consist of applying a legal syllogism. Within the scope of

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21 See HMRC “Resolving Tax Disputes. Practical Guidance For HMRC Staff On The Use Of Alternative Dispute Resolution In Large Or Complex Cases”, p.3.

22 For instance, section 145 of the South African Tax Administration Act provides for the circumstances where settlement is inappropriate, among others, when in the opinion of SARS the settlement would be contrary to the law or a practice generally prevailing and no exceptional circumstances exist to justify a departure from the law or practice; or it is in the public interest to have judicial clarification of the issue and the case is appropriate for this purpose.
legality, different types of behavior are possible which may be included within the broad concept of discretion, where the administration’s normal unilateral decision may be replaced by a negotiated procedure and a bilateral decision.

170. Some tax law provisions are open to different reasonable interpretations. If a particular ambiguous provision involves numerous cases, litigation may be appropriate so as to arrive at a general resolution of the ambiguity. On the other hand, isolated cases might more efficiently be dealt with through ADR, as long as both parties are ready to find a reasonable solution.

171. Concerning facts, in tax cases often no objective truth exists that can be found by an impartial investigator, and, as a result, the question is not establishing the existence of certain events but rather one of interpreting a number of items of evidence. In these cases ADR can successfully substitute for litigation.

172. Therefore, especially appropriate for an ADR approach are those cases where different interpretations of the law in the specific case are possible and different opinions on factual determinations can be reasonably defended, such as when the facts cannot be well known for whatever reason (e.g., the facts are not fully documented or they are too numerous and complicated). Valuation or allocation issues are examples.

C. Types of ADR mechanisms

173. ADR might adopt multiple forms and can be classified from different points of view.

Cooperative approach to large taxpayers.

174. A general cooperative approach to taxpayers can avoid a significant number of conflicts. This should, however, be neither new nor alternative.

175. This type of approach can be upgraded by means of enhanced relationship to some taxpayers, which the OECD calls “cooperative compliance”. It is based on transparency and trust from both sides. From a cost efficiency point of view, enhanced cooperation is specifically appropriate for the largest taxpayers due to their reduced number, the amounts usually involved and their greater capacity to challenge tax administration decisions. This may be especially easy to introduce in countries with Large Taxpayer Units. In taxing the largest taxpayers there are always some topics which are controversial in nature and long lasting, such as transfer prices. This is the reason why this type of relationship is especially appropriate to deal with transfer pricing and similar problems on a permanent, day to day, basis. If these problems are not properly dealt with they will lead inevitably to continuous litigation.


24 The FTA Study of Tax Intermediaries (2008, www.oecd.org/dataoecd/28/34/39882938.pdf) recommends an enhanced relationship between tax administrations and their large business customers. In the same sense, the (continued…)
176. Cooperative compliance as in the horizontal monitoring in the Netherlands can be a suitable model. In horizontal monitoring, taxpayers enter into a formal agreement with the Netherlands Tax and Customs Administration, which establishes a tax control framework to ensure early knowledge of tax risks, including transfer pricing issues. Horizontal monitoring is based on three key principles: mutual trust, understanding, and transparency. It was first piloted in the very large business segment becoming later a well established program extended to other taxpayer groups. The system involves reciprocity: on the one hand, the tax administration commits itself to make tax compliance easier and more secure and on the other hand, taxpayers “put all their cards on the table” showing they are acting in good faith, thus minimizing exposure to penalties and interest. Because of that taxpayers need confidence that there will be a serious attempt to resolve the issues.

177. A cooperative approach to taxpayers can also encompass the different negotiation techniques as provided for in legislation. An example of the results of a cooperative approach to large taxpayers and negotiation techniques are advance price agreements, which can be bilateral or multilateral, with binding effects for all parties, thus, avoiding disputes within their scope, on a long-term basis.

178. APAs were an early form of ADR. The difference between APAs and the negotiation techniques analyzed below is that APAs avoid disputes as they establish procedures to deal with problematic issues that will appear repeatedly in the future. On the contrary, the techniques analyzed below have the goal to resolve concrete disputes already arisen.

Resolving disputes by negotiation

179. Negotiation is the traditional approach to informal dispute resolution between taxpayers and the revenue authority, but in the context of the formal transactional relationships created by legislation.25

180. Three possibilities can be differentiated: 1) independent third party mediation/conciliation (where both parties accept a third party intervention in the procedure to get them together in cases where it is no longer possible for them to reach an agreement on their own), 2) settlements (agreements between the tax administration and the taxpayer), and 3) arbitration (the parties agree to accept the decision made by an independent third party).


There is growing evidence from tax administrations and tax advisors alike that good quality engagement improves compliance and early resolution of issues. See OECD publication on Dealing Effectively with the Challenges of Transfer Pricing (2012, http://dx.doi.org/10.1787/10.1787/9789264169463-en).

181. These three possibilities respond to the difference that can be drawn conceptually. In practice, they may appear in those clear terms or they may represent a continuum. For example, settlement is often the result of conciliation/mediation techniques.

182. All the different types of agreements included in the concept of ADR can be provided for outside the protest/appeals procedure as an alternative to it. This does not exclude the possibility of embodying some of these mechanisms in the traditional protest/appeals procedure.

183. The U.S. ADR system is a good example of these mechanisms being embodied in the traditional tax procedures, as well as of the sliding scale of negotiation in them. While starting during the audit procedure by means of the agreements reached between the taxpayer and the tax auditor without special formalization, when disagreement remains, different types of mediation techniques are used by the IRS Appeals officials during the same audit procedure to settle cases, outside the appeals procedure. When these mechanisms fail and the appeal takes place, the appeals official can settle the case taking into account the hazards of litigation.

**Conciliation/Mediation**

184. Conciliation is a process in which the parties to a dispute, with the assistance of a neutral third party (the conciliator), identify the disputed issues, consider alternatives, and endeavor to reach an agreement. It can be distinguished from mediation in that a conciliator may have an advisory role on the content of the dispute and give expert advice on likely settlement terms. The mediator assists the parties in the decision making process without giving advice on the contents.  

185. The difference between conciliation and mediation, however, might be insignificant in practice.

186. An example of this technique commonly used in alternative dispute resolution for non-tax issues is Early Neutral Evaluation. This involves an assessment of a case by an independent and impartial person appointed and paid by both parties on the basis of each party’s supporting evidence and legal arguments. This impartial evaluator (usually a lawyer, retired judge or other expert) expresses a view on the merits of each side's case, helping the parties avoid formal and expensive dispute resolution processes, such as litigation.

187. ENE and similar techniques are non-binding processes that provide an unbiased evaluation of the relative strengths of each party’s position, giving guidance on the likely outcome should the dispute go further without a significant change in approach by one or both parties.

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26 See Bentley, supra note 26, at 175, quoting NADRAC, p.116.
The end result sought by these techniques is that the parties reach an agreement to terminate the dispute. Therefore, although the decision to use this kind of technique is voluntary for both parties, if an agreement is reached, it must be binding for them.

Agreements on mediation/conciliation/ENE, being limited to the decision to submit the case to these techniques, can be considered outside the protest/appeals systems or can play a role in the context of the traditional ways of resolving disputes. In the latter case these types of procedures are embodied in the protest/appeals procedures within the tax administration, or even at a previous stage, during the audit procedure.

Mediation techniques are also increasingly common in the court system, as utilized in pre-trial hearings, where the judge plays a role as mediator/conciliator.

This is, for instance, the case for the pre-trial meeting between tax administration and taxpayers convened by the judge in the German tax court as a sort of mediation procedure which can be very effective, without depriving the judiciary of its primary responsibility for adjudicating cases and without depriving taxpayers of their right to a fair trial. This is also the case for early referral to appeals (a clear case of ENE) and the different mediation techniques used in U.S. audit and appeals procedures, where appeals officials play the role of mediator/conciliator.

Because they do not constitute a separate procedure, they are not strictly speaking ADR, but rather a reasonable and effective way to conduct the protest/appeals procedures where the officials/judges in charge play a role in trying to convince the parties to accept a reasonable resolution of the dispute. To be able to carry out such a role effectively, specialized tax officials and specialized judges are needed.

Another possibility is for the taxpayer to retain a third party private mediator, paid by the taxpayer, outside the protest/appeals system and outside the court. This is foreseen in the laws of several countries, including the U.K. and the U.S. This third party should help the taxpayer and the tax administration find a solution to the dispute. The appropriateness of this approach can be questioned, however, on the basis that the administration should be able to furnish mediation/conciliation services on its own and not put the taxpayer to this expense.

Settlements

HMRC has recently been looking at piloting Alternative Dispute Resolution (ADR), using mediators. Apparently, a justification for this is that “every time HMRC has looked more closely, it has realized that what is needed is something far simpler – a reassessment of the case, proper consideration of its merits or otherwise using a fresh pair of eyes and a reinvigorated action plan developed jointly with the business. In every case considered so far, that is all that has been needed to progress the case further”. See the OECD publication on Dealing Effectively with the Challenges of Transfer Pricing (2012, http://dx.doi.org/10.1787/10.1787/9789264169463-en), p. 46.
194. Two types of settlement between the tax administration and taxpayers can be differentiated: pre-litigation settlements and settlements reached during litigation. Pre-litigation settlements can take place as part of appeals procedures, or separately.

195. Although a settlement is a contract agreed exclusively by the parties, settlements reached during litigation must be made known to the court so that they may be incorporated into the ongoing legal action in order to terminate it. Similarly, settlements reached during the protest/appeals procedure must be taken into account by the competent appeals official to terminate the dispute.

196. Agreements reached as the result of a mediation/conciliation procedure are also a sort of settlement.

197. A settlement between a taxpayer and the tax administration requires a legal basis. Therefore, the cases where these types of agreements can be made and the basic procedural rules should be set forth in legislation. As long as these agreements are legally recognized, they must have the authority of res judicata. This means that the settlement binds the parties in the same way as a final court judgment, and is not subject to further challenge.

198. A good example of settlement practices is the work of the IRS Appeals Office in the U.S., as this sort of dispute resolution is by appeal to the Office of Appeals (“Appeals”), which within the IRS has the authority to consider the settlement of tax controversies and is charged with resolving disputes, to the maximum extent possible, without resorting to litigation. Not every case referred to Appeals can be settled. For example, settlement is not permitted unless the taxpayer is able to demonstrate real uncertainty in law or fact as to the correct application of the relevant law to the case. Appeals officers focus on the evidence available in a case and have to assess the law that applies to an issue, and to resolve disputes without litigation on a basis that is fair to both taxpayer and government and which will enhance voluntary compliance. A fair and impartial resolution is one that reflects on an issue-by-issue basis the probable result in the event of litigation, or that reflects mutual concessions for the purpose of settlement based on the relative strength of the opposing positions where there is a substantial uncertainty of the result in the event of litigation.

199. In the U.K. the Litigation and Settlement Strategy (LSS or “the Strategy”) is the framework within which HMRC seeks to resolve disputes through civil procedures consistently with the law, whether by agreement with the taxpayer or through litigation. The Strategy was first introduced in 2007. The two key elements of HMRC’s approach to tax disputes are:

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28 The Appeals Office is very successful in settling cases of all types with a success rate in excess of 80% of the cases referred to it. See OECD publication on Dealing Effectively with the Challenges of Transfer Pricing (2012, http://dx.doi.org/10.1787/10.1787/9789264169463-en), p. 53.

29 See HMRC “Resolving Tax Disputes, Practical Guidance For HMRC Staff On The Use Of Alternative Dispute Resolution In Large Or Complex Cases”.
• supporting taxpayers to get their tax right the first time, so preventing a dispute arising in the first place; and

• resolving those disputes that do arise in a way that establishes the right tax due at the least cost to HMRC and to taxpayers, which in most cases will involve working collaboratively.

200. The LSS encourages HMRC staff to minimize the scope for disputes and seek non-confrontational solutions. In cases where HMRC’s position is strong it tries to settle for the full amount HMRC believes the courts would determine, or, where that is not possible, it goes to litigation. HMRC considers it preferable to concede weak cases rather than go to litigation.

201. In appropriate cases, Alternative Dispute Resolution (ADR), and more specifically mediation, can help HMRC and the taxpayer resolve disputes in a cost effective and efficient manner.\(^3\)\(^0\)

202. The LSS reflects all three of HMRC’s key strategic objectives by considering: a) the overall effectiveness of disputes handling (to reduce costs), b) to maximize revenue flows as quickly and efficiently as possible and c) to improve customer experience.

203. Resolving disputes ‘cost effectively’ does not mean HMRC making compromises on what it believes to be the right tax liability consistent with the law. It means securing the right tax liability consistent with the law, fairly and even-handedly across all taxpayers, in a way that minimizes unnecessary costs.\(^3\)\(^1\)

\(^3\)\(^0\) The key issues in deciding whether or not to litigate are likely to be some or all of the following:
- From the tax administration perspective, do a transfer pricing specialist and a litigation lawyer agree that the case is a strong one that can be won?
- Is a significant amount of tax at stake?
- Have all attempts to negotiate a reasonable settlement failed?
- Is the case likely to be the subject of consultation under the Mutual Agreement Procedure provided for in a double taxation agreement?
- Is there evidence of good quality to support the tax administration’s arguments and has that evidence been proved (can someone speak authoritatively to the source of the evidence) and properly examined by lawyers and specialists?
- Are expert witnesses needed and, if so, what are they going to speak to? Has their evidence been fully tested?
- Could the time and money costs of litigation outweigh the benefits of success?
- Do legal precedents support the tax administration’s position?

The answer “No” to any one of the above questions may lead to a decision that litigation is inappropriate and that further negotiation or a form of alternative dispute resolution would be more appropriate. HMRC does not litigate speculatively and if on balance the case appears likely to be lost in litigation, it will not be pursued.

\(^3\)\(^1\) This means, as the HMRC guidance makes explicit, that the concept of cost-effective dispute resolution in the guidance may be different from the generally understood concept of cost-effective resolution of a purely commercial dispute.
Arbitration

204. Arbitration is a process in which the parties to a dispute present arguments and evidence to a neutral third party (the arbitrator) who makes a determination.\(^\text{32}\)

205. The justification for this third party intervention is the agreement reached between the parties to a dispute to submit the case to a private arbitrator, as arbitration must be based on the parties’ voluntary agreement. Therefore, in the event of introducing private arbitration techniques to the resolution of tax disputes, in principle, the tax administration should not be forced by the taxpayer to be subject to this procedure.\(^\text{33}\)

206. When analyzing the possibility of introducing arbitration techniques in the field of taxation, the question arises as to who the arbitrator should be. If the arbitration procedure is embedded in the framework of traditional dispute resolution systems, the arbitrator will not be designated by the parties to the dispute, being either an appeals official, or an administrative quasi-judicial body (with or without some representation of the taxpayers), or a judge/court.

207. A revenue officer in a problem resolution unit, or in a protest/appeals unit, independent from the decision making unit, is a sort of arbitrator. However, as they are inside the tax administration, they can be accused of lacking real independence. This is the reason for the existence of the administrative bodies formally independent from the revenue agency. Nevertheless, there are not fundamental reasons for the appeals offices not being independent in their work as there are technical mechanisms to guarantee organizational independence and they can be subject only to the law and not to collection considerations.\(^\text{34}\)

208. On the other hand, the possibility of private arbitrators in tax questions can be questioned on the basis that it signifies that public law and a strong public administration is subject to the decision of a private party. While the entire system to apply the tax laws, organized during centuries by the state, is subject to the rule of law and to important tax principles within the constitutional framework it is difficult to envisage a similar system of checks and balances to include within it the functioning of private arbitrators in the field of taxation.

\(^\text{32}\) See Bentley, supra note 26, at 177, quoting p.119.

\(^\text{33}\) As an exception to this rule, in Georgia, in 2005, ADR was introduced into the tax appeal system through the creation of Tax Arbitration Councils where disputes were to be resolved pursuant to the procedural rules established by the Law on Private Arbitration and the arbitration option could be exercised on the taxpayer’s demand without the consent of the tax administration. As arbitration was awarded only to permanently acting private and independent arbitral institutions, government officials being excluded from acting as arbitrators, the Georgian tax arbitration system favored taxpayers and allowed bias against the tax administration, contributing to its quick repeal after only four months. Another exception is Portugal; see annex.

\(^\text{34}\) The prohibition of ex parte communications of US appeals officials with revenue officials is an efficient instrument to warrant independence from the reviewed agents.
209. As a result, arbitration is unlikely to be private in the tax context. It must be a more formal arbitration set up within the framework of the dispute resolution system.  

210. Administrative committees or quasi-judicial bodies can play a role when the required conditions of independence and prestige are met. Such committees can play a sort of arbitration role when they are staffed not only by civil servants but also by taxpayer’s representatives, or representatives of different technical bodies present in the civil society (architects, engineers, accountants, etc.). These committees are most appropriate to deal with difficult questions of fact which cannot have a clear definite answer, such as valuation questions. If these bodies are well staffed, representative, and well functioning they can avoid a fair amount of disputes.

D. Some concerns about ADR in tax law

211. In general terms, the vagueness in practice of the procedures included within the concept of ADR leads to a concern about possible misuse. In order to minimize this problem, a certain level of formalization is needed, together with a clear definition of the cases where ADR is possible and a clear strategy and tight governance around reaching the conclusion whether or not to negotiate or litigate.

212. One key point on agreements reached under ADR is the authority responsible for them, the way powers are structured and organized. When they are concentrated at top decision-making levels, they can be better controlled, but transparency mechanisms (such as records and publications with due care of privacy rights) must be in place to avoid misuse.

213. When these mechanisms have to be used at a lower level in the organization, clear rules have to be in place as to the cases where they can be applied, the procedure to follow, and the civil servants responsible. Absent these, mediation/settlement techniques could be dangerous for the civil servant behind them as he could be liable as set down in administrative or criminal provisions.

214. Although ADR procedures can play a significant role resolving tax disputes, they cannot be considered a replacement for litigation in all cases, as one of the fundamental roles of the state is to guarantee the principle of legality of taxation and taxpayer protection within the public law framework.

215. Due to the principle of legality, ADR has to be provided for by law or regulations. As public law and important constitutional principles are implicated, they are acceptable only in cases where either the law or the facts are unclear.

VII. TAX OMBUDSMAN

35 See Bentley, supra note 26, at 177.
216. The office of tax ombudsman, which has been introduced in a number of jurisdictions, can help assure a smoother interaction between tax officials and taxpayers, thereby also helping to resolve disputes or prevent disputes from arising. The forms of these offices vary, as they can be integrated in the general ombudsman office\textsuperscript{36} or they can be tax specific. Also the competences vary as they can be more or less broad and effective. The role of the tax ombudsmen also differs depending on the legal system and constitutional framework in different countries.

217. The main characteristic of ombudsmen is their role outside the organizational framework of the executive branch, which warrants independence, but explains its most important weakness, which is that the ombudsmen typically do not make legally binding decisions, their role being limited to try to get the administration to solve problems and to make the right decisions as, even in cases lodged with the ombudsmen, it is the normal authority within the executive branch who continues to be in charge of making the decision.

218. Typically, lodging a case with the tax ombudsman is a separate procedure from the protest/appeals procedure. Therefore, this office cannot substitute for any of the traditional protest/appeals mechanisms, but can play a role trying to help them work better.

219. In tax disputes, the tax ombudsman works as a kind of mediator/conciliator, between taxpayers and tax administration to solve problems in a less adversarial way than by means of litigation. This is the most typical role for this institution, by which it might affect the protest/appeals procedures, putting an end to the dispute when it succeeds in bringing both parties together. However, judicial review is always available when the taxpayer is not satisfied with the administrative decision made after the tax ombudsman's intervention in the case.

VIII. MONITORING CASES IN DISPUTE

220. In order to identify problem areas in the functioning of protest/appeals systems, and to design appropriate solutions, it is critical to set up a system to track information about pending and resolved cases. This information should consist of two types of data: 1) data concerning each dispute continuously updated as the dispute proceeds; 2) statistical data concerning pending and resolved cases. The information system should be computerized and should, in the case of regionally organized tax administrations, be consolidated nationally.

A. Data related to specific cases

221. For efficiency purposes, a case tracking service should be introduced so that either party could establish the exact status of their appeal, ideally through an on-line facility with

\textsuperscript{36} Australia has successfully introduced a Special Tax Adviser in the Office of the Commonwealth Ombudsman, while the UK uses a Revenue Adjudicator. In US there is a Taxpayer Advocate, who reports directly to the Commissioner of the IRS. See Bentley, supra note 26, at 128.
appropriate password protection. Some countries may, of course, not be in a position to set up a service that is accessible by taxpayers, since that may involve additional cost and complexity.

222. In order to be of lasting significance, the outcomes of appeals cases need to be communicated to all auditors, and built into future training, to ensure future assessments properly reflect appeals decisions, both administrative and judicial. If a system of objectives is in place to assess the tax auditing work, the results of the appeals should be connected to the system as a necessary feedback.

223. To allow this, as well as statistical control of the whole system, every primary decision that is being disputed should have associated with it in the information system all data related to the complete protest/appeals procedure. To this end, the primary decision must be assigned an ID code.

224. Through this code the deciding section within the tax administration and the type of decision (assessment/refund/registration/penalties, etc.) should be accessible, as well as the tax and tax period. The amount of tax, penalties, and interest assessed must also be included in the database. The type of taxpayer should also be identified (using the categories generally employed by the tax administration in classifying taxpayers).

225. In cases where the primary decision relates to several taxes/tax periods, as they can be protested separately they should be adequately differentiated, with all data referred to above related to every tax period and tax involved.

226. The first protest/appeals procedure should be linked to the tax ID. The data recorded for this procedure should be the day of lodging the protest/appeal, the type (in case of different alternatives of protest/appeal) of procedure, the office in charge of resolving it, and the amount protested. Where possible, the amount protested should be broken down into separate amounts for each main issue involved in the protest, and these issues should be categorized under a taxonomy to be developed.

227. The amount in dispute is an important data item. As tax cases are complex and often involve a number of issues, an attempt should be made to differentiate the issues involved with the approximate amount in dispute related to each one of them. The reason for this is to have timely information about the amount really in dispute at every moment, as decisions at the different levels of the protest/appeal procedure may partially accept and deny the taxpayer’s complaint. This information also allows for calculating what is really at stake taking into account what will likely be the end result of the open procedures with the approximate amount of tax to collect or refunds to make. To have this information in the course of the protest/appeal procedure it is necessary to have the information on the amount involved associated with the issues disputed. Gathering this information of course will require someone to calculate the partial amounts for each issue. The calculation need not be precise, however; an estimate will do.

228. Preparing a taxonomy of issues is not an easy task. At any given time, the tax administration has a limited number of topics which are the most relevant. Only these topics
should be chosen (others can be classified as miscellaneous). Because of that, the relevant topics chosen have to be few and really important. A useful way to make the selection is to connect them to the plan of objectives of the revenue agency, as this will point out the topics which are considered most relevant for the revenue agency during the selected time period. When new topics appear the system must be updated as old topics may not be relevant any more. Of course, any topics involving a substantial number of pending cases should be included.

229. The decisions made in every step of the protest/appeals procedure must be recorded (indicating their dates) connected to the previous decisions on the case and together with the information related to whether it confirms completely the administrative decision or rejects it completely or partially confirms and rejects.

230. In this case, if, as above mentioned, the different issues discussed were taken into account with their respective tax amounts in the record of the protest/appeal, the information related to the topics confirmed or rejected and to their respective amounts should be easily available and considered in the appeals decision and its record.

231. Recording a new decision in the proceeding should not mean that the data related to previous decisions can be deleted, as they are relevant up to the final decision which can overrule intermediate decisions, thus, upholding the initial decision protested. Moreover, these data can be used to track the functioning of the appeals process on a statistical basis.

232. Whether the amount owing according to the protested decision has been totally or partially paid or not paid should be recorded, together with any additional payments made (or amounts collected through enforced collection procedure during the course of the protest/appeals proceeding). The date when the amount must be paid and the dates when it is totally or partially paid with the respective amount should be recorded.

233. It might also be useful for the tax administration to enter into the system at the time a case goes to court its own estimate of the probability of success. In complex cases, this should be broken down by issue. This estimate can be useful as a way for case managers to evaluate settlement offers. It can also be used to track results: do court results consistently come out roughly as predicted, or are there surprises? If so, is there a pattern? This kind of data could help managers analyse and adjust future litigation strategy.

234. Once the final decision is made and implemented, the terms of the implementation should be recorded following the same structure of data previously used, with the date of implementation and exact amounts decided by the last instance, whether it is the court or a previous administrative instance not appealed against in due time.

235. For transparency and control reasons, there should be an obligation to publish all protest/appeals/court decisions on the website of the Revenue Agency or the court within a reasonable time limit, with due protection of the taxpayer’s identity if needed. (Countries differ in terms of the extent of information published about court cases, and tax should as a general matter follow the general practice.)
B. Statistical data about pending disputes

236. On the basis of the above-discussed data related to each particular case, the system must be able to produce reports on all disputes. Whatever the computer system in place, it must be able to connect in every logical way all the above mentioned data, which should be able to be organized by time period of filing the protest/appeal, taxes, tax period, sections of the administration that made the decision, type of decision, time period of every decision in the protest/appeals procedure and time period between decisions at every different stage of the procedure.

237. Therefore the information system should be able to show statistics about the time taken by the different stages of the procedure up to the final decision. Also the results of each stage (upholding/overruling, partially both, and amounts involved) in the procedure should be able to be dealt with for statistical purposes.

238. To guarantee transparency, key statistical data about the protest/appeals process should be published on the web site of the revenue agency. For this purpose, an Annual Report should be produced by the appeals office covering, amongst other issues:

- The number of appeals lodged during the year.
- The number of cases heard in the year.
- Amounts of tax involved.
- Successful parties i.e. number, and amounts, won by the revenue agency and number won by the taxpayer, and the cases settled at the last minute.
- The number of cases awaiting hearing.
- The number of cases awaiting decision.
- The average waiting period between lodging an appeal and having it heard and resolved.
- The total budget allocated to the Appeals Office for the year.
- - The actual total expenditure of the Appeals Office for the year.
- The same should apply to the decisions of administrative courts and to the judicial decisions on tax cases.

C. Use of the information collected

239. The data collected and the statistics based on them can be used as a management tool for multiple purposes:
• They can be used by the tax administration to keep track of the procedure in specific cases and at the same time to guarantee the taxpayers the right to know the exact situation of their cases.

• The statistical data are needed for the managerial function for tax audits to know the results of the job done, as they allow the degree of acceptance by the courts of tax assessments, and the results of the challenges, to be known, thus allowing for changes when they are not considered adequate.

• The statistical data can be used to improve the government's litigation strategy.

• These data can allow appeals officers to better estimate the hazards of litigation.

• These data are relevant for internal control, as they facilitate evaluating the real performance of the different parts of the tax administration and even of specific civil servants, allowing for a better control under a system of measuring performance by objectives.

• The monitoring system also fosters uniformity in the activity of the tax administration as differences of treatment are made evident.

• The system provides the tax administration and the taxpayers with better information about the case law, which allows adapting to it, avoiding new disputes arising on issues already resolved and allowing the termination of disputes started on issues after they can be considered settled by the judiciary.

• The data can be used as a prompt for the tax administration to publish its position on specific decisions; thus disputes will be avoided with risk-averse taxpayers which will adapt to this position.

• Information on issues discussed and type of taxpayers involved allows for a more accurate approach to different types of taxpayers and different issues.

• As the tax administration has information about court decisions it can better calculate the real risks for the budget of the decisions being challenged at every moment and make better estimates of the possible revenue.

• These data allow the legislative branch to exercise better oversight over the tax function of the government, improving democracy.

• The publication of these data fosters transparency and a better understanding of taxation, improving acceptance of the system or, otherwise, forcing the government to make the necessary changes.
IX. DEALING WITH HEAVY BACKLOGS OF CASES

240. Some countries experience a particularly serious problem involving a large number of cases in court, or at the administrative level, or both, involving substantial amounts of uncollected tax. This might be a particular concern for a country in an economic crisis that involves a crisis in the public finances. This section discusses measures that can be taken to deal with this problem.

241. The first measure to properly deal with heavy backlogs is to organize an efficient protest/appeals system within the tax administration (including ADR procedures), thus avoiding an increase in the backlog of cases.

242. In countries where the judicial case backlog has reached such an extent that the judicial system cannot properly resolve the cases in a reasonable time, special measures could be adopted, depending on the situation and the country. All these measures present some problems related with important principles, such as the principles of legal security and equal treatment before the law. However, they may be preferable to the denial of justice which extremely lengthy judicial proceedings imply.

243. The following measures could be used to help solve the problem of heavy case backlogs in a speedy way:

1. A survey analyzing the type of cases stalled should be undertaken.

   The criteria should be the starting date of the protest/appeals procedure, the tax, the tax period, and the amount of tax (including penalties and interest). When possible, the main topics in dispute and the respective amounts should be taken into account.

   However, making an accurate survey is unlikely to be possible. Most likely the needed data will not be available when the system is not well functioning. Nevertheless, an effort should be made on the basis of assumptions of experienced tax administrators that could allow at least the main lines of the problems to be analyzed and possible ad hoc solutions to be designed.

   For instance, if some topics are identified as important (and this should be known according to the tax administrators’ experience) because there are many similar cases or they involve high amounts, the introduction of preliminary rulings on key points issued by the upper court level establishing case law could speed the solution of many cases.

2. Analyzing whether a portion of the cases in dispute otherwise have a common element that would allow a joint solution. Depending on what common element is involved, the solution might be reachable administratively, might be achieved as part of the litigation process, or might require legislation. For example, suppose that a large volume of cases involves the classification of staff as employees versus independent contractors. These cases might be dealt with by legislating some bright
line rules that resolve this problem. (Depending on the situation, legislation might affect future cases only.)

Another example might be a large volume of cases coming from a particular district office the audit results of which tend to be excessive and unreliable. In this event, appropriate administrative steps can be taken, e.g., changing the management of the office concerned.

(Some cases might of course be the result of the same audit procedure, and these should be merged for purposes of analysis.)

Similar cases might also be merged to be considered jointly by the court.

3. Analyzing whether cases in dispute are the consequence of new administrative decisions on cases previously appealed and reversed. (see paras. 149-156)

These cases should be dealt with not as new decisions by the revenue agency subject to independent review, but as incidental problems in the implementation of the decision of the protest/appeals body. This will bring the problem back to the first decision protested/appealed, thus avoiding the need to make a complete new ruling on the apparently new case, solving it only by way of some instructions to the administration as to the way the first ruling should be implemented.

4. A general offer to settle cases in court could be made by means of a one-time reduction of the penalty imposed, in case the taxpayer withdraws the taxpayer's complaint. This would be a one-time application of what might otherwise be a permanent policy, but perhaps at a different level of penalty abatement (see para. 24)

5. At the same time penalties for frivolous continuation of a pending case could be established or increased. (see para.87)

6. Taxpayers could be required to pay the cost of the appeal in cases where the court completely upholds the administrative decision. (see para 87)

7. A system similar to that recently introduced in Italy could be retroactively introduced by law.

This is a system of protest before a separate office of the tax administration, with an important component of negotiation/mediation. The decision could be made to send all or a subset of cases to an administrative appeals office with some component of ADR. This should be done in a very flexible way, but duly recorded and controlled.

37 This is the mediation procedure has been introduced in Italy for complaints filed on or after April 1, 2012. See annex below.
Some other ADR mechanisms could be considered, as for example in Portugal where arbitration mechanisms have been introduced, which apply to cases already stalled in courts.

8. If there are two court instances, the cases where the amount of tax in dispute exceeds a specified amount could be referred to the upper instance while the first instance could be transformed into an exclusive instance to consider cases where the amount in dispute is below that amount.

9. Cases up to a certain amount could be referred to individual judges, instead of a multi-judge bench.

10. Special tax chambers could be set up within the court system.

11. A specialized task force could be introduced to help the judiciary to resolve cases speedily but with appropriate technical care.

12. The court procedures could be simplified by legislation.

13. Provisions requiring payment of the tax during the protest/appeals procedures could be introduced as well as provisions on the payment of interest (see para. 42, 49)

X. CHECKLIST

The following is a checklist of potential measures, each of which tends to reduce the number of tax disputes. Not all of these measures will be suitable in a given country, and they are not necessarily all recommended – as the text explains, some of them involve trade-offs. Nevertheless, the checklist can be used as a tool in a diagnostic exercise to identify areas where reform might be appropriate.

1. Ensure that the tax laws are well drafted. (para. 10).
2. Minimize the frequency of amendment of tax laws. (para. 10)
3. Publish guidance for taxpayers. (para. 11)
4. Adopt a flexible approach in agreeing payment arrangements. (para. 43)
5. Provide for adequate but reasonable penalties and interest (at a floating rate). (para. 49-57)
6. Ensure that the tax administration takes a generally cooperative approach to taxpayers (para. 12)
7. Explore whether there are rules leading to a substantial volume of disputes that can be replaced by bright-line rules that would be easier to apply (para. 10)
8. Make sure that auditors are trained and encouraged to resolve disputes during the audit process. (para. 15)
9. Eliminate incentives for overly aggressive assessments. (para. 3)
10. Incorporate a mediation/conciliation procedure before an assessment is formally made. (para. 21)
11. If there is no formal mediation/conciliation procedure, make sure that the taxpayer has an informal opportunity to discuss the case within the unit making the decision before a final decision is taken (para. 98)
12. Take administrative actions that lead to a greater culture of taxpayer compliance (para. 9).
13. Examine whether the frequency of protests suggests unreasonable behavior on the part of the tax administration (para. 27).
14. Specify in the law and limit the administrative decisions that may be protested (para. 37).
15. Ensure that all decisions arising from the same audit (including imposition of penalties) are considered in the same protest/appeal case (para. 38-41).
16. Require tax to be paid pending appeal (para. 42-48).
17. Make sure that the burden of proving that an assessment is incorrect is on the taxpayer (para. 58-62).
18. Make sure that the scope of judicial review is appropriately narrow, consistently with the legal system (para. 63-71).
19. Provide that administrative silence constitutes a deemed rejection of a protest (para. 72-77).
20. Ensure skilled representation of the government in tax cases (para. 82-83).
21. Eliminate the rule of reformatio in peius if it exists, consistent with the legal system (para. 84-86).
22. Provide for imposition of penalties for frivolous appeals (para. 87).
23. Provide for taxpayers to be able to recover the costs of a successful appeal (para 89).
24. Require exhaustion of administrative remedies before an appeal can be filed in court (para. 95).
25. Train and encourage appeals officers to decide each case without a bias in favor of the tax administration (para. 103).
26. Provide for specialized tax courts or, where this is not possible, specialized chambers that approximate specialized tax courts as far as possible. (para. 133)
27. Institute ADR mechanisms at the administrative level (para. 161-209).
28. Ensure that the government’s litigation strategy includes a concession of weak cases (para. 194).
29. Institute a tax ombudsman. (para. 210-213).
30. Ensure there is a good system for monitoring cases at the protest and appeals stages. (para. 214-233).
31. Consolidate cases with common issues for joint resolution (para. 237).
32. Provide for reduction of penalties for taxpayers who refrain from protesting an assessment (para. 24, 237).
33. Provide that a taxpayer is required to pay the cost of an appeal that the taxpayer loses (para. 87, 237).
34. Provide streamlined procedures for small tax cases (para. 145).
XI. ANNEX

A. Germany

**Tax Disputes Resolution in Germany: Protest/appeals procedure**

244. The first step in the procedure is protest before the same office making the protested decision (within one month from its notification). This office tries to solve the problem in an informal manner by openly discussing the case with the taxpayer.

245. Most protests (60-90%, depending on the office) are disposed of as a result of this discussion: either the taxpayer is convinced of not being right, or the protest is accepted (for example, because the taxpayer presents new evidence), or both parties reach the conclusion that in uncertainty the appropriate result can fall within a range, finding a solution which is acceptable for both. In the last two cases the section makes a new assessment which is no longer contested by the taxpayer. When the case is not solved by the decision making section, it sends the case directly to the appeals section (die Rechtsbehelfstelle), at the same hierarchical level as other sections in the tax office, independent from them, and whose only function is reviewing appeals.

246. This also works in a very informal and speedy manner, discussing with the taxpayer, personally or by phone, partly recognizing the right of the taxpayer, partly convincing the taxpayer of not being right, partly finding a solution in between.

247. Only when the taxpayer is not satisfied and willing to go to court, is there a formal reasoned decision on the protest, notified to the taxpayer, who is allowed to go to court within one month. An action before the court is only possible in principle if the taxpayer has first exhausted the out-of-court appeal proceedings. However, the court can be appealed to directly if the public authority agrees to this, or if the revenue authority fails to respond with a decision on an objection within a reasonable period and without giving an adequate reason for failing to do so.

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38 Pars. 347-367 Abgabenordnung (AO) (Fiscal Code). The procedure before the court is ruled in the Finanzgerichtsordnung (FGO) (General Regulation of Finance Courts). In Germany, tax administration is organized at the level of the Länder (regions). Therefore, procedures may vary from one Land to another.

39 [http://www.bundesfinanzministerium.de/Content/DE/Monatsberichte/2012/10/Inhalte/Kapitel-3-Analysen/3-4-einspruchsbearbeitung-in-finanzaemtern.html?__act=renderPdf&__iDocId=283580](http://www.bundesfinanzministerium.de/Content/DE/Monatsberichte/2012/10/Inhalte/Kapitel-3-Analysen/3-4-einspruchsbearbeitung-in-finanzaemtern.html?__act=renderPdf&__iDocId=283580)
248. A written decision occurs in approximately 10-15% of the cases. The decision is typically very short.

249. Collection of the tax assessed is in principle unaffected by the protest. However, while the case is being considered in this section the assessment is often not implemented and the tax not collected. The tax will be collected only after the decision of the appeals section, whose review is a pre-requisite to go to court.

250. The court is a specialized line in the judiciary; consisting of the Fiscal Courts (Finanzgerichte) and their upper review level: the Federal Fiscal Court (Bundesfinanzhof). Altogether, 63,381 complaints were filed in court against the tax offices in the year 2011; this corresponds to about 1.5% of total objections.

251. While the case is before the court, it continues under the responsibility of the appeals official, who continues discussing with the taxpayer, often reaching an agreement, under which the taxpayer withdraws the case from the court. In other cases, the judge often convenes a pre-trial meeting, where the appeals officials represent the tax administration.

252. The role of the judge is very active, directing the discussion as a sort of conciliator, trying to get the parties to an agreement. The pre-trial meeting is very informal and speedy (typically scheduled for about 2 hours). Proofs and documents are personally analyzed by the judge.

253. When an agreement is reached, the judge writes a report, and the tax administration makes the agreed decision. When there is no agreement a public trial is convened before the court, which issues a ruling on the case. The ruling is not subject to review unless the court so decides, depending on whether there is consolidated jurisprudence on the problem in dispute. Most rulings uphold the administrative decision. Rulings of the Fiscal Courts may be appealed against on points of law to the Federal Fiscal Court, if the appeal is granted by the Fiscal Court or the Federal Fiscal Court. Either the taxpayer or the tax authority may appeal.

40 [http://www.bundesfinanzministerium.de/Content/DE/Monatsberichte/2012/10/Inhalte/Kapitel-3-Analysen/3-4-einspruchsbearbeitung-in-finanzaemtern.html?__act=renderPdf&__iDocId=283580](http://www.bundesfinanzministerium.de/Content/DE/Monatsberichte/2012/10/Inhalte/Kapitel-3-Analysen/3-4-einspruchsbearbeitung-in-finanzaemtern.html?__act=renderPdf&__iDocId=283580).

41 Par. 361 AO.

42 Par. 44 FGO.

43 Until 1968 these courts belonged to the executive branch and were staffed with tax officials (lawyers from the tax administration “Hoehere Dienst”, that is the upper level of civil servants). In 1968 these courts were transformed into specialized judicial courts which continued to be staffed mostly the same way. For the public hearing 5 judges compose the court, 2 of whom are selected citizens, not professional judges.

44 [http://www.bundesfinanzministerium.de/Content/DE/Monatsberichte/2012/10/Inhalte/Kapitel-3-Analysen/3-4-einspruchsbearbeitung-in-finanzaemtern.html?__act=renderPdf&__iDocId=283580](http://www.bundesfinanzministerium.de/Content/DE/Monatsberichte/2012/10/Inhalte/Kapitel-3-Analysen/3-4-einspruchsbearbeitung-in-finanzaemtern.html?__act=renderPdf&__iDocId=283580).
254. The time from the administrative assessment until the final court decision might be between 1 and 3 years, depending on whether there is review before the Federal Fiscal Court.

B. Italy

255. A so-called mediation procedure has been introduced in Italy\textsuperscript{45} for complaints against tax agency decisions with a value up to 20,000 Euros\textsuperscript{46} filed on or after April 1, 2012. Controversies without specified value (e.g., denial of registration) are not subject to the mediation phase of the procedure.

256. The goal of the procedure, which is a mix between ADR and traditional protest before the tax administration, is to discharge the judiciary of tax complaints and improve relationships between taxpayers and the tax administration, giving the latter the opportunity to correct mistakes.

257. Mediation in this procedure differs from the mediation provided for in civil and commercial controversies\textsuperscript{47} and is alternative to judicial mediation,\textsuperscript{48} which is excluded in these cases. The procedure does not suspend the obligation to pay the tax and is a prerequisite for judicial appeal. The grounds for the complaint must coincide with the grounds for the judicial appeal and the papers to be filed consist of an administrative protest, explaining the motives (of fact and law) of the complaint, filed before the tax agency’s provincial or regional tax directions issuing the protested decision, within 60 days of its communication. This protest can be accompanied by a reasoned proposal for mediation which can include a concrete amount of tax.

258. The legal services are charged with the procedure. They analyze the taxpayer’s reasons and nullify the previous decision when considered appropriate. If not, the mediation proposal is analyzed. If it is not accepted or there is no proposal, the office will make a mediation proposal taking into account the hazards of litigation by way of: i) uncertainty of the questions in dispute, ii) degree of sustainability of the claim, iii) efficiency of administrative action. The proposal could also be an offer to reduce the penalty to 40% of the tax owing. This reduction is always a result of the agreement.

259. All the procedure can be informal, by e-mail, or personal interviews (the taxpayer can send a representative). The agreement between the taxpayer and the legal services has to be written and complete, and excludes further dispute of the case. The agreement must be

\textsuperscript{45} By law of 15 July 2011, which changed the legislative decree of 31 December 1992, n. 546, by adding article 17-bis, under rubric “Il reclamo e la mediazione” (complaint and mediation).

\textsuperscript{46} For that purpose the value is related to every tax and period, without interest and penalties, or the value of the penalty in case of protesting only this. When several taxes are the object of the controversy all them are added. Art. 12.5 Legislative Decree n. 546, 1992.

\textsuperscript{47} Legislative Decree, n. 28, of March, 4\textsuperscript{th}, 2010.

\textsuperscript{48} In art. 48 of Legislative Decree 546, 1992.
reached within 90 days, after which without agreement the taxpayer’s petition is considered denied.

260. As these agreements occasionally could be considered as a renunciation of public revenue, they could entail some risk of the civil servants involved being held liable by the court of public accounts. To avoid this risk, it is expressly regulated that the responsibility before the “Corte dei Conti”, in matters of public accounts, of the civil servants acting in the procedure is limited to intentional actions.

261. The agreement is treated as null if the taxpayer fails to pay the tax agreed on within 20 days or, if agreed on installments, fails to pay the first installment.

262. If an agreement is not reached the administrative decision upholdning the protested decision has to be motivated. The taxpayer has 30 days to go to court, subject to a fee which does not apply in the mediation procedure.

263. The party losing the case before the court will have to pay 150% of the trial costs (100% of the cost of the judicial procedure and 50% of it as estimated cost of the analyzed administrative mediation procedure).

C. Netherlands

Horizontal monitoring in the Netherlands

264. Based on a report of the Scientific Council for Government Policy and growing criticism of the Netherlands Tax and Customs Administration, the tax authorities undertook a self-assessment. As part of this exercise they interviewed several multinational enterprises and the Dutch employers’ organisation VNO-NCW, finding out that companies considered the tax administration too negative in their work attitude, and too much focused on conflicts rather than on solutions. As a consequence, companies shared as little information as possible

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49 See “Guide on Horizontal Monitoring within the medium to very large businesses segment” published by The Netherlands Tax and Customs Administration, 30 November 2010, primarily intended to specify the framework to be used in everyday practice. See also Schepers, Dennis “Horizontal monitoring: Is the Dutch system perfect?”, Master Thesis Fiscal Economics 1 July 2010, Maastricht School of Business and Economics.


Since 2005 there have been several developments to enhance the relationship between Her Majesty's Revenue and Customs (HMRC) and multinationals. In 2006 the Irish Tax and Customs Administration introduced a whole new approach for large businesses, called cooperative compliance. In 2006 the Australian Taxation Office published the ‘Large Business and Tax Compliance’ report, which tried to improve the relationship with companies and to reduce the amount of extensive audits. In October 2009 the Korean National Tax Service started a 15-month pilot horizontal monitoring. This is in line with agreements made by the OECD Forum on Tax Administration in Seoul 2006 and Cape Town 2008 to cooperate against aggressive tax planning.
with the tax administration. This negative relationship between the two parties led to an increase of the administrative burden of both parties.\(^{51}\)

265. At the beginning of 2005 the Netherlands Tax and Customs Administration began a pilot project which examined whether the supervision of the very large businesses can be designed on the basis of the principles laid down in the PAO. This involved so-called horizontal monitoring, which is a framework for cooperation between the taxpayer and the tax administration. In 2006, the project was expanded to include the small and medium sized segment. The pilot ended in 2007 and was considered a success by both taxpayers and the tax administration, more effective and efficient than the old system.\(^{52}\)

266. Horizontal monitoring is considered to make the Netherlands more attractive for multinationals by reducing the administrative burden and fostering a good fiscal climate.

267. Before applying horizontal monitoring, the tax administration tries to solve all the tax issues from the past, thus, increasing legal certainty, because tax issues are directly discussed up front and solved with the tax administration, reducing, at the same time, opportunities of tax evasion.

268. Horizontal monitoring provides the following advantages for companies:

1. Certainty in advance
2. Less rigorous audits afterwards
3. Agree to disagree
4. Fast settlement of previous years

269. The only formal requirement for applying horizontal monitoring is the availability of a good internal control framework for taxes, the so called Tax Control Framework for applying horizontal monitoring.

270. The key point in horizontal monitoring is cooperation between the tax authority and the taxpayers. This co-operation is laid down in a compliance covenant, signed by both the taxpayer and the tax administration, which forces taxpayers to be actively involved in the tax assessment process.

271. This does not mean that companies are not able to use all the normal legal tax planning opportunities, as long as they are transparent about it: horizontal monitoring is about fair play. Companies can also go to court in case of disagreement with the tax administration, according to the principle of ‘agree to disagree’. This means that both parties

\(^{51}\) Some critics say that horizontal monitoring is only introduced because vertical supervision has not fulfilled its goal.

\(^{52}\) According to data from the survey “Tax is a Black Box II” by PWC, 2008, Amsterdam.
agree to co-operate, but also agree to let each other go to court in the case of different interpretations.

272. By signing the compliance covenant the tax administration agrees to provide certainty in advance about the tax risks that are reported by the taxpayer. This reduces the workload of both the tax administration and businesses.

273. The compliance covenant does not increase the administrative burden of companies, and does not require any extra information/effort of companies other than those required by law: the obligation to provide the tax administration sufficient information arises from the law and not from the compliance covenant.

274. The compliance covenants are regularly and randomly checked by the tax administration to see whether companies are compliant with all the aspects of the covenant. Although the administration cannot impose penalties for breaking the covenant, which is not covered by the Tax Administrative Penalty Decision, if the taxpayer does not fulfill the taxpayer’s duties the tax administration can impose an administrative fine. The taxpayer could also face criminal prosecution.

275. The covenant is not enforceable by court. As there is no arbitration board that could settle any disputes they should be solved among both parties themselves.

276. The phases of the client profile in the ATK+ application for horizontal monitoring are as follows:

- phase 1: client profile.
- phase 2: horizontal monitoring is/is not feasible.
- phase 3: insight into the design and existence of the administrative organisation/internal control.
- phase 4: insight into the existence and operation of the administrative organisation/internal control.
- phase 5: adjustment of form and intensity of supervision.
- phase 6: covenant with a tax service provider.

277. Each of these phases encompasses a variety of practical steps, producing an output. For instance, for Phase 2, the output can include the following:

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53 ATK+ is the abbreviation (in Dutch) for “individual account management application” and is used as the permanent file for each of the participants in the program.
- minutes of the horizontal monitoring meeting (shared with the organisation).
- written report of the kickoff meeting for the compliance scan.
- written report of the compliance scan, with the evaluation, conclusions and agreements.
- when applicable: settlement agreement for pending issues.
- when applicable: assessment procedure for past years.
- compliance agreement.
- an updated client profile and strategic supervision plan in ATK+.
- preliminary consultations.

278. The prevailing circumstances at the time of the horizontal monitoring meeting, compliance scan and the conclusion of the compliance agreement can subsequently change. For this reason all covenants include arrangements for periodic evaluations.

D. Portugal

Tax Arbitration in Portugal

279. Arbitration as an alternative means of dispute resolution using neutral and impartial third parties (the arbiters) whose decisions have the same legal value as court judgments was introduced\(^5\) to the Portuguese legal system by Decree-Law 10/2011 of 20 January. The Order in Council 112-A/2011 of 22 March - as approved by the ministers of finance, public administration and justice - was published to establish the terms under which the authorities are bound by tax arbitration proceedings. The regulations on costs of tax arbitration proceedings were published in April and the regulations on selection of arbiters for tax arbitration were published on 1 June. The system entered into force on July 1, 2011.

280. The right to refer to arbitration is a prerogative of the taxpayer, and is not at the discretion of the Tax Authorities. The legislation takes into consideration the specificities of tax arbitration, determining that arbitrators must decide cases based on statutory law not equity.

281. The legislature did not aim to bind the tax authorities to arbitral proceedings in every type of claim, so there are claims excluded from the system, which are, among others, the

\(^5\) As result of criticisms of ineffectiveness toward Portuguese tax litigation and the increased mistrust of taxpayers in relation to tax decisions, arbitration was introduced in order to reduce the number of lawsuits currently “congesting” the Administrative and Tax Courts, to increase the speed of resolution of disputes that bring the tax authorities up against taxpayers. A further objective was the possibility of resolution of tax disputes by arbitration reducing the time taken to deal with administrative and tax cases.
declaration of illegality of self-assessment acts, withholding taxes and payments on account that have not been preceded by an administrative appeal, customs duties on imports and other indirect taxes that apply to goods subject to import duties, tariff classification, origin and customs value of the goods and the tariff quotas.

282. There is a further limitation based on value, as the tax authorities are not bound to arbitral proceedings in disputes with a value greater than €10,000,000.

283. Only the Directorate General for Taxes and the Directorate General for Customs and Excises come under the jurisdiction of the tax arbitration tribunals, whereas some other authorities that have powers over tax issues are not bound to arbitral proceedings, such as municipal councils and the social security authorities even though they fall within the concept of tax authorities as set out in the Lei Geral Tributária or General Taxation Law.

284. The only tribunals that have jurisdiction to hand down tax arbitration awards are those that operate within CAAD, the Centre for Administrative Arbitration. The Conselho Superior dos Tribunais Administrativos e Fiscais (Higher Council for Tax and Administrative Courts) appoints the president of the Conselho Deontológico of CAAD.

285. The composition of the tax arbitration tribunal depends on whether or not the taxpayer nominates an arbiter. If the taxpayer nominates an arbiter, the tax arbitration tribunal will function as a collective (three arbiters), with each of the parties nominating one arbiter and these two arbiters nominating the third presiding arbiter.

286. In cases in which the taxpayer decides not to nominate an arbiter, if the value of the case is below the jurisdictional limit of the Central Administrative Court (€60,000), the tribunal will function with a single arbiter to be appointed by the CAAD professional ethics council. If the value at issue exceeds the mentioned amount, the tribunal will function as a collective of three arbiters, also to be appointed by the CAAD professional ethics council.

287. In disputes with a value equal to or greater than €500,000, the presiding arbiter must have carried out public duties as a judge in the tax courts or have a master’s in tax law. In disputes with a value equal to or greater than €1,000,000 the presiding arbiter must have carried out public duties as a judge in the tax courts or have a doctorate in tax law. Although the Chairman must always have such a degree (and at least 10 years’ of documented experience in the field of tax law), in cases of high complexity demanding specific knowledge of non-legal matters, the arbiters can have degrees in Economics or Management.

288. By filing an arbitration request, taxpayers automatically give up their right to a common administrative and judicial appeal against the final award.

289. The arbitration decision has the same enforceability as that attributed to final and non-appealable court rulings. This means that in the event of the failure of the tax authorities to comply with awards, taxpayers may have recourse to the means of enforcement of judgments provided for in the Code of Procedure in Administrative Courts.

290. There are exceptional cases in which the arbitration decision may be appealed to the Constitutional Court (when the arbitral award refuses to apply a rule on the basis of its
unconstitutionality or applies a rule the constitutionality of which has been challenged), to the Supreme Administrative Court (the arbitral award is in opposition to the same fundamental issue of law on which there is a judgment of the Central Administrative Courts or the Supreme Administrative Court), to the Central Administrative Court (on the basis of the failure to specify the factual and legal grounds on which the award was based, as well as in cases in which the grounds for the award contradict the award itself, cases where the tribunal fails to address relevant issues or where the award goes beyond the tribunal’s remit, or violation of adversarial principles or equality between the parties).

291. A referral for a preliminary ruling to the Court of Justice of the European Union is also possible whenever a question as to the interpretation of the European Union treaties is raised in the tax arbitration tribunal or a question on the validity or interpretation of acts adopted by institutions of the European Union.

292. The arbitration fee is calculated on the basis of two fundamental criteria: the amount at issue and the way in which the arbiters are appointed. The payment is borne in full by the taxpayer and must be made by bank transfer to CAAD’s account before the request is made for the tax arbitration tribunal to be convened.

293. The arbitration procedure shall not exceed a term of six months (renewable a maximum of three times, for terms of two months each).

E. South Africa

294. After objection to SARS, taxpayers may channel tax disputes with SARS through one of the following:

- Alternative Dispute Resolution (ADR).
- The Tax Board, with jurisdiction when the tax in dispute does not exceed R 100,000.
- The Tax Court, with jurisdiction when the tax in dispute is in excess of R100,000.\(^57\)

\(^{55}\) As a rule, this is determined on the basis of the provisions on the Code of Tax Procedure and Process.

\(^{56}\) Chapter 9, “Dispute Resolution”, of the Tax Administration Act, No. 28 of 2011 (TAA). This law incorporates into one piece of legislation administrative provisions which were duplicated in different tax Acts, for example, the objection and appeal procedures. As a result, the provisions previously included in sections 107 A and B of the INCOME TAX ACT, NO. 58 of 1962, have been deleted in the Schedule of Amendments to the TAA and new revised rules will be issued under TAA section 103 which allows the Minister to issue rules governing the procedures to lodge an objection and appeal against an assessment or decision, and the conduct and hearing of an appeal before a tax board or tax court. These rules may provide for alternative dispute resolution procedures under which SARS and the person aggrieved by an assessment or decision may resolve a dispute.

\(^{57}\) The amount is determined by the rules mentioned in previous footnote. Tax court decisions can be appealed to the full bench of the Provincial Division of the High Court which has jurisdiction in the area in which the tax court sitting is held or to the Supreme Court of Appeal in the terms foreseen by TAA section 133.
295. Regulations on alternative dispute resolution procedures and settlement as a form of dispute resolution other than litigation were introduced under sections 107A and B of the Income Tax Act, effective from 1 April 2003 in pursuance of enhancing SARS’ client services, and included two different procedures:

   a) Mediation: Rule 7 of section 107A made provision for alternative dispute resolution (ADR) which can be initiated by either the taxpayer or SARS.

296. The taxpayer can initiate ADR in the specified form for appeal (to be lodged within 30 days of the date of the notice of disallowance or alteration of the assessment in consequence of the taxpayer’s objection) against the assessment by indicating “refer to ADR”. SARS determines within 20 business days whether the matter is suitable for ADR.

297. If the Commissioner is of the opinion that a matter is appropriate for ADR, the Commissioner must inform the taxpayer within 10 days of the receipt of the notice of appeal, requiring the taxpayer to notify the Commissioner in writing within a further 10 days whether the taxpayer agrees to ADR.

298. In case of agreement on the procedure, SARS will appoint a facilitator (normally a trained and experienced SARS officer) who will endeavor to resolve the dispute between the parties. The facilitator is bound by a code of conduct and must seek a fair, equitable, and legal resolution of the matter, arranging an informal meeting where both parties will state their case and provide evidence. The facilitator cannot make a ruling or decision which binds the Commissioner or the taxpayer, nor may compel the parties to settle the dispute.

299. Settlement: The basic rule is that SARS must enforce legislation and is obliged to assess and collect all amounts due to the State. The settlement provisions provide guidelines as to the circumstances where it would be inappropriate to settle, for example:

   • If in the opinion of SARS, the action on the part of the taxpayer which relates to the dispute constitutes tax evasion or fraud.

   • The settlement would be contrary to the law or a clearly established practice of SARS on the matter, and no exceptional circumstances exist to justify a departure from the law or practice.

   • It is in the public interest to have judicial clarification of the issue and the case is suitable for this purpose.

   • The pursuit of the matter through the courts will significantly promote compliance and the case is suitable for this purpose.

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58 The appeal must be on the form prescribed by SARS (ADR2) and must indicate in respect of which of the grounds specified in the objection the taxpayer wishes to appeal.
• The taxpayer has not complied with the provisions of any Act administered by SARS and SARS is of the opinion that the noncompliance is of a serious nature.

300. In settling a matter, SARS must have regard to a number of factors, which are sufficient to make the case problematic in outcome or unsuitable for resolution through the alternative dispute resolution procedures or the courts, including:

• Whether that settlement would be in the interest of good management of the tax system, overall fairness and the best use of SARS’ resources.

• The cost of litigation in comparison to the possible benefits with reference to: i) the prospects of success in a court; (ii) the prospects of the collection of the amounts due; and (iii) the costs associated with collection.

• Whether there are any (i) complex factual or quantum issues in contention; or (ii) evidentiary difficulties.

301. Settlement is also possible in a situation where a participant or a group of participants in a tax avoidance arrangement has accepted SARS’ position in the dispute, in which case the settlement may be negotiated in an appropriate manner required to unwind existing structures and arrangements; or when the settlement of the dispute will promote compliance by the taxpayer or a group of taxpayers or a section of the public in a cost-effective way.

302. The agreement must be signed by a senior SARS official. SARS will issue, where necessary, a revised assessment to give effect to the agreement or settlement.

303. SARS must (a) maintain a register of all disputes that are settled under this provision; and (b) document the process under which each dispute is settled.

304. The Commissioner must provide an annual summary of settlements to the Auditor-General and to the Minister, in a format that does not disclose the identity of the person concerned; and contain details, arranged by main classes of taxpayers or sections of the public, of the number of settlements, the amount of tax forgone, and the estimated savings in litigation costs.

F. United States

Tax Dispute Resolution in the U.S.

Appeals to the IRS Appeals Office

305. When the taxpayer does not agree with any or all of the IRS findings in an examination/audit procedure, the taxpayer may request a meeting or a telephone conference with the supervisor of the person who issued the findings.
306. If the taxpayer still does not agree, the taxpayer may appeal to the Appeals Office of IRS, which will take a fresh look at the case and can settle most differences in a fair and impartial manner taking into account the hazards of litigation.\(^{59}\)

307. The protest must be sent within the time limit specified in the letter received by the taxpayer. If the total amount for any tax period is not more than $25,000, (including penalties), the taxpayer may make a small case request instead of filing a formal written protest.

308. The Appeals Office is the only level of administrative appeal within the IRS, separate from - and independent of – the rest of the IRS. Conferences with Appeals Office personnel are held in an informal manner by correspondence, by telephone or at a personal conference. Most differences are settled at this level.

309. To ensure independent Appeals function, ex parte communications between Appeals personnel and other Internal Revenue Service personnel are prohibited.

310. If the taxpayer does not appeal to the IRS Appeals Office the taxpayer will receive a formal Notice of Deficiency which allows going to the Tax Court within 90 days (as a general rule) from the date of the notice. If the taxpayer does not file a petition with the Tax Court within this period the IRS will assess the proposed liability sending the bill to the taxpayer, and this assessment can no longer be appealed in the Tax Court.

**Appeals to the Courts**

311. If the taxpayer and Appeals don’t agree on some or all of the issues after the Appeals conference, or if the taxpayer skips the IRS appeals system, the taxpayer may take the case to the United States Tax Court, the United States Court of Federal Claims, or the corresponding United States District Court.

312. These courts are independent judicial bodies and have no connection with the IRS.

**Tax Court**

313. If the disagreement with the IRS is over additional income tax, estate tax, gift tax, certain excise taxes or penalties related to these proposed liabilities, the taxpayer can go to the United States Tax Court.\(^{60}\) The tax is not collected until the end of the procedure. Other

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\(^{59}\) Not every case referred to Appeals can be settled. For example, settlement is not permitted unless the taxpayer is able to demonstrate there is real uncertainty in law or fact or both as to the correct application of the relevant law to the case.

\(^{60}\) The United States Tax Court is staffed with experts in taxation. The United States District Court is not specialized in taxation. The United States Court of Federal Claims is fairly specialized in taxation. The courts of appeal and the U.S. Supreme Court are generalist courts.
types of tax controversies, such as those involving some employment tax issues cannot be heard by the Tax Court.

314. If the Tax Court determines that the case is intended primarily to cause a delay, or that the taxpayer’s position is frivolous or groundless, the Tax Court may award a penalty of up to $25,000.

**District Court and Court of Federal Claims**

315. If the claim is for a refund of any type of tax, the taxpayer may take the case to the United States District Court or, alternatively, to the United States Court of Federal Claims. Certain types of cases excluded from the tax court, can be heard only by these courts.

316. Generally, the District Court and the Court of Federal Claims hear tax cases only after the tax has been paid and filed a claim for refund with the IRS. If the IRS does not respond within 6 months, the taxpayer may file suit for a refund immediately in the District Court or the Court of Federal Claims.

317. If the IRS sends a letter disallowing the claim, the taxpayer may request Appeals review of the disallowance and/or file a refund suit with these courts. The refund suit must be filed no later than 2 years from the date of the notice of claim disallowance letter.

318. Appeal from all of these courts lies to the courts of appeal and eventually to the Supreme Court (which hears appeals on a discretionary basis).

**Alternative Dispute Resolution**

*Fast Track Mediation*

319. It is designed to help Small Business/Self Employed (SB/SE) taxpayers resolve many disputes during the examinations (audits) procedures. Appeals personnel trained in mediation help the taxpayer and an IRS representative discuss the issues involved in the disagreement, and possible ways to resolve it in order to reach a jointly agreeable solution, consistent with relevant law, within forty days.

320. Most cases not docketed in any court qualify for fast track mediation. Excluded cases are, among others, issues with no legal precedent and issues where the courts’ decisions differ.

321. The taxpayer and the IRS representative must sign an agreement to mediate before the first mediation session. The taxpayer does not need to file a written protest to request fast track mediation and retains all the usual appeal rights for any issues that do not get resolved through fast track mediation.

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61 Introduced by IRS Restructuring and Reform Act (1998); Internal Revenue Code Section 7123.
Fast Track Settlement (FTS)\(^{63}\)

322. FTS offers taxpayers a way to resolve audit issues during the examination process, within 120 days, as general rule. It is available for certain LMSB (Large and Mid-Size Business) and SB/SE (Small Business/Self Employed) taxpayers, as well as to other IRS Operating Division taxpayers on a case-by-case basis for factual and legal issues, including issues that require consideration of the hazards of litigation.

323. Prior to issuance of Form 5701 (Notice of Proposed Adjustment), the LMSB team and the taxpayer should agree on all the facts and circumstances and exhaust LMSB resolution authority on the issues. When it appears that the taxpayer may not agree with issues raised during the examination process, the taxpayer should have an early discussion with the LMSB Team Manager on possible use of the FTS process.

324. Taxpayer may request (in a one-page application) Fast Track Settlement after Form 5701 or other similar document has been issued and the taxpayer has provided a written response. FTS brings Appeals resources to the audit site to resolve the dispute before the 30-day letter is issued. A specially trained Appeals employee facilitates the discussion between the taxpayer and the team manager or group manager to reach and execute a settlement with which both agree.

325. Fast Track Settlement is not available in certain situations, for example, issues designated for litigation.

326. The taxpayer may withdraw from the Fast Track Settlement process at any time. After the taxpayer, LMSB and the Appeals Official sign the Fast Track Settlement Session Report acknowledging a basis of settlement, the Appeals Official (working with both parties) will draft the appropriate settlement document to reflect the agreed upon treatment of the issue.

327. If any issues remain unresolved at the conclusion of the Fast Track Settlement process, the taxpayer retains all of its otherwise applicable appeal rights.

328. Written documents disclosed by the taxpayer during the Fast Track process become available to LMSB and may be used in their determination.

Mediation\(^{64}\)

\(^{63}\) Revenue Procedure 2003-40.

\(^{64}\) Revenue Procedure 2009-44.
329. Mediation is an extension of the Appeals process. The mediator’s role is to help resolve the dispute only after good faith negotiations in Appeals have been unsuccessful. Mediators may come from Appeals, or the taxpayer can use non-IRS co-mediators, at the taxpayer’s own expense.

330. Mediation is optional and available for both factual issues, such as valuation and transfer pricing issues, and legal issues. The IRS representative and the taxpayer must sign an agreement to mediate before the first mediation session. It is not needed to file a written protest to request fast track mediation. The mediator will not require either party to accept a certain outcome.

1. **Early Referral to Appeals**\(^{65}\)
   
   Best utilized relatively early in the examination process when there are one or more developed, unagreed issues, and there are other undeveloped examination issues. The first are referred to Appeals, while the other issues continue to be developed in LMSB.

2. **Arbitration**\(^{66}\)
   
   Taxpayers may request arbitration for qualifying factual issues already in the Appeals administrative process after settlement negotiations are unsuccessful.\(^ {67}\) Legal issues are excluded.
   
   If settlement negotiations are unsuccessful, the taxpayer or Appeals may request binding arbitration after consulting with the other party.
   
   The prohibition of ex parte communications between Appeals personnel and other Internal Revenue Service personnel does not apply to the communications arising in Fast Track Settlement or Fast Track Mediation because Appeals personnel, in facilitating an agreement between the taxpayer and LMSB or SB/SE, are not acting in their traditional Appeals role.

331. The taxpayer may be able to recover reasonable litigation and administrative costs if the taxpayer is the prevailing party. For this the taxpayer must exhaust the administrative remedies within the IRS. This means that a taxpayer will normally have had to refer their issue to Appeals before going to Court.

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\(^{65}\) Revenue Procedure 99-28.

\(^{66}\) Revenue Procedure 2006-44.

\(^{67}\) Arbitration is also available after unsuccessful attempts to enter into a closing agreement under Internal Revenue Code section 7121.