Department of the Treasury
Internal Revenue Service
Office of Chief Counsel

Notice

N(35)4(16)(12)-0

August 18, 1999

Subject: Qualified Offer Rule for Recovery of Reasonable Administrative and and Litigation Costs - Section 7430 **Cancel Date:** February 14, 2000

GENERAL

Section 3101 of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA98), Pub. L. No. 105-206, made several modifications to I.R.C. § 7430, including the addition of a qualified offer rule effective for costs incurred after January 18, 1999. Taxpayers are making qualified offers pursuant to this provision. This notice addresses the positions to be taken in responding to assertions by taxpayers that they are entitled to an award of costs based upon the qualified offer rule. A regulation project to implement the qualified offer rule is on the 1999 Priority Guidance Plan and may address the issues discussed in this Notice. Thus, the positions stated herein should be considered as interim; further guidance may be provided upon the issuance of the regulation if necessary.

Qualified Offer Rule

In general, a prevailing party may recover the reasonable administrative and litigation costs incurred in administrative and court proceedings if the proceedings relate to the determination or refund of any tax, interest or penalty under the Internal Revenue Code. Under the statute, as amended by RRA98, the making of a qualified offer may result in the taxpayer being a prevailing party for purposes of a recovery of costs. A taxpayer is a prevailing party by reason of making a qualified offer if the taxpayer's liability under the last qualified offer would equal or exceed the amount of the taxpayer's liability under the judgment entered by the court.

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Additional Requirements For Qualifying as a Prevailing Party

To qualify as a prevailing party under the statute, taxpayers must meet the net worth requirements of section 7430(c)(4)(A)(ii). Furthermore, to qualify for an award, taxpayers must meet the remaining requirements of section 7430, such as not unreasonably protracting the proceedings and, for purposes of an award of litigation costs, exhausting their administrative remedies. On the other hand, a taxpayer qualifying as a prevailing party by reason of having made a qualified offer need not substantially prevail on either the amount in controversy or the most significant issue or set of issues presented. Similarly, whether the positions of the United States in the administrative and litigation proceedings were substantially justified is not relevant for an award under the qualified offer rule.

A taxpayer cannot qualify as a prevailing party under this rule if the determination of the court with respect to the adjustments included in the last qualified offer is entered exclusively pursuant to a settlement. Neither can a taxpayer qualify as a prevailing party under this rule in any proceeding in which the amount of tax liability is not in issue, including any declaratory judgment proceeding, any proceeding to enforce or quash any summons issued pursuant to the Internal Revenue Code of 1986, and any action to restrain disclosure under section 6110(f).

Comparison of Liability Under the Offer to Liability Under the Judgment

The comparison of the taxpayer's liability under the qualified offer with the liability under the judgment is central to the operation of the qualified offer rule. Other than the statement in section 7430(c)(4)(E)(ii)(I) to the effect that the qualified offer rule does not apply to any judgment issued pursuant to a settlement, the statute is silent regarding how the liability under the judgment is determined. Given the multiplicity of issues frequently present in tax litigation and the intention expressed by Congress in instituting the qualified offer rule to "provide an incentive for the IRS to settle taxpayer's cases for appropriate amounts," we believe that a qualified offer must encompass all of the adjustments at issue at the time the offer is made, and must be compared to the outcome at the end of the litigation on all of those adjustments and only those adjustments.

Consequently, our position is that the liability under the judgment entered by the court is that liability attributable to the adjustments included in the last qualified offer that were actually determined by the court through litigation, plus the amount of any additional adjustments subject to the last qualified offer that were determined by settlements entered into after the making of the last qualified offer. Under this position, adjustments raised subsequent to the making of the last qualified offer by any party are ignored in determining the liability of the taxpayer to be compared with the liability under the last qualified offer.

Fees Recoverable

An award based upon the taxpayer having made a qualified offer is limited to those reasonable administrative and litigation costs incurred on or after the date of the last qualified offer. If the taxpayer is a prevailing party without regard to the qualified offer rule, the reasonable administrative and litigation costs to which the taxpayer is thus entitled may not be awarded again by reason of the taxpayer having made a qualified offer. On the other hand, it is our position that even though some costs in a proceeding may be awarded without regard to the qualified offer rule, it is possible for other costs in the same proceeding to be awarded under the qualified offer rule. For instance, costs incurred in different portions of the proceedings or with regard to different adjustments at issue may be awarded under the qualified offer rule despite the awarding of other costs without regard to the qualified offer rule.

Qualified Offer

A qualified offer is a written offer that: 1) is made by the taxpayer to the United States during the qualified offer period; 2) specifies the amount of the taxpayer's liability (determined without regard to interest); 3) is designated as a qualified offer at the time it is made; and 4) remains open until the earliest of the date the offer is rejected, the date the trial begins or the 90th day after the date the offer is made. It is our position that, in order to meet the requirement that the offer specifies the amount of the taxpayer's liability, the offer must establish the taxpayer's liability (determined without regard to interest) by setting forth the dollar amount of the taxpayer's offer, as stated above, on all of the adjustments at issue in the proceeding at the time the qualified offer is made. Furthermore, we will treat the fourth requirement, that the offer remain open until the earlier of the date rejected, trial begins or 90 days, as being met if, by its terms, the offer remains open at least until the earlier of those dates. If such an offer were to remain open longer than those three minimum periods, it would not fail to meet this requirement.

Qualified Offer Period

Aside from the minimum period during which a qualified offer must remain open, a qualified offer must be made during the qualified offer period. That period begins on the date the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals is sent. The qualified offer period ends on the date which is thirty days before the date the case is first set for trial. In the United States Tax Court, cases are placed upon a calendar for trial and at the calendar call cases are scheduled for a specified day for trial during that trial calendar. Consequently, in determining when the qualified offer period ends for cases in the Tax Court and other courts of the United States using calendars for trial, we will consider a case to be set for trial on the date scheduled for the calendar call. Cases may be removed from a trial calendar at any time. Thus, a case may be removed from a calendar before the date which is thirty days before the date scheduled for that calendar. In order to promote the settlement of such cases, we will consider the qualified offer period to remain open until the case remains on a calendar for trial on the date which is 30 days before the scheduled date of the calendar call for that trial session. The qualified offer period may not be extended, although the period during which a qualified offer remains open may extend beyond the end of the qualified offer period.

Any questions concerning the foregoing may be directed to the Income Tax & Accounting Branch of the Field Service Division at (202) 622-7900.

/s/ *Daniel J. Wiles*

for JUDITH C. DUNN
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(Domestic)