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A dispute systems design evaluation of the tax dispute resolution system in the United States and possible recommendations from Australia

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Abstract

A number of studies have been conducted which utilise dispute systems design (DSD) principles to evaluate the Australian tax dispute resolution system. Notwithstanding that the United States is regarded as a relatively mature jurisdiction in terms of the use of alternative dispute resolution (ADR) in resolving tax disputes, to date few studies have been conducted utilising DSD principles to evaluate the US tax dispute resolution system. Accordingly, this article evaluates the tax dispute resolution system in the US using DSD principles and consequently makes possible recommendations for improvements to the system drawing from certain DSD features of the Australian tax dispute resolution system.

Key words: Dispute systems design, tax dispute resolution, alternative dispute resolution, United States, Australia

1. INTRODUCTION

7KHUH DUH D YDULHW\ RI IDFWRUV WKDW LQIOXHQFH V

5HYLHZ LQWR WKH $XVWUDOLDQ 7D[DWLRQ 2IILFH¶V *Dispute Resolution*[19] in 2012, which made a number of recommendations including piloting the use of in-house facilitators to assist in resolution of disputes involving less complex indirect tax disputes.[20] Subsequently, the ATO has rolled out an in-house facilitation service with effect from 1 April 2014.[21] Another recent driver behind ATO ADR has been the µsignificant change agenda¶ of the current Australian Commissioner of Taxation, Mr Chris Jordan AO.[22] Since 2013 the ATO has embarked on a transformation SURMHFW µ5HLQYHQWLQJ WKH $7 2¶ to transform how it goes about its core business, and make it a contemporary and service-oriented organisation ¶[23] Managing and resolving tax disputes in a way that is µHIILFLHQW UHVSHFWIX including through the use of ADR, has formed part of the transformation project.[24]

A number of studies have been conducted with respect to the utilisation of DSD principles in evaluating the tax dispute resolution system in Australia.[25] However, notwithstanding its relatively mature use of ADR in tax dispute resolution, to date, only one study has been conducted to evaluate the US tax dispute resolution system from a DSD perspective.[26] Against this background, this article seeks to evaluate the tax dispute resolution system of the US utilising DSD principles. Based on the DSD evaluation made, the article then makes suggestions for improvements to the system from the DSD perspective of the Australian tax dispute resolution system. In addition to having already been evaluated

have traditionally not been regarded as interests-based disputes.[34] McDonough states WKDW WD[GLVSXWHV « DUH PRUH W\SLFDOO\ DGGUHVVHG RQ GROODU DPRXQWV DORQH ZLWKRXW FRQVLGHULQJ as opposed to considering the needs and interests of each party.[35] In a tax dispute the individual interests of parties tend to be subsumed in the argument over legal rights. It is usually only when the parties enter into a formal effort to resolve the conflict that interests are taken into account.[36] It thus follows that the movement by revenue authorities towards the use of interests-based ADR processes such as facilitation and mediation is consistent with the concept of the creation of interests-orientated systems underpinning DSD.

A number of principles have been put forward by various practitioners for best practice in DSD.[37] Systems that follow these general design principles are generally thought to be more likely to produce positive dispute outcomes and improve the RUJDQLVDWLRQ¶V overall capacity for effective conflict management.[38] The earlier tax DSD studies conducted in Australia by Bentley[39] and Mookhey[40] utilised a set of six DSD principles originally proposed by Ury, Brett and Goldberg. These principles were as follows:[41]

1. Create ways for reconciling the interests of those in dispute.
2. %XLOG -LQD EHWZHHQ SDUWLHV to encourage disputants to return to negotiation.
3. Provide low-cost rights DQG SRZHUIXO µEDFN
4. Prevent unnecessary conflict through notification, consultation and feedback.
5. Arrange procedures in a low to high cost sequence.
6. Provide the necessary motivation, skills and resources to allow the system to work.

However, consistent with the more recent tax DSD evaluations conducted by the author,[42] this study utilises a more comprehensive set of 14 DSD principles synthesised

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[34] Bentley, *Taxpayers ¶ 5LJKWV 7KHRU\ 2UL*, above n 9, 383; P SOHPHQWDWLRQ

[35] .LUVWHQ - 0F'RQRXJK µ5HVROYLQJ)HGHUDO 7D[Arbitration SXWHV 7KU *Journal* 38, 41.

[36] Bentley, 7D[SD\HUV¶ 5LJKWV 7KHRU\ , above n 10, 381 DQG , P SOHPHQWDWLRQ

[37] See Ury, Brett and Goldberg, above n 10; Costantino and Merchant, above n 10; 0DU\ 3 5RZH µ'LVSXWH Resolution in the Non-Union Environment: An Evolution Toward Integrated Systems for Conflict 0DQDJHPHQW" ¶ LQ 6DGL Frontiers in Dispute Resolution HG *Labor Relations and Human Resources* (Michigan State University Press, 1997) 79; Jennifer Lynch, *CCRA: Contemporary Conflict Resolution Approaches* (Canada Customs and Revenue Agency, 1998); Karl A Slaikeu and Ralph H Hasson, *Controlling the Costs of Conflict: How to Design a System for Your Organization* (Jossey-Bass, 1998); Society for Professionals in Dispute Resolution, *Designing Integrated Conflict Management Systems: Guidelines for the Design of Integrated Conflict Management Systems within Organizations* ( )RU D V\QWKHVLV RI WKH '6' SULQFLSOHV SURSRVHG E\ WKH %XLOGLQJ IRU &RQIOLFW 0DQDJH (2000) 6 *Conflict Resolution Quarterly* 215, ¶ LQ

[38] 7LQD 1DEDWFKL DQG From Postal to Federal: Dispute Systems Design in the USPS REDRESS® 3URJ (2010) 30(2) *Review of Public Personnel Administration* 211, 215.

[39] %HQWOH\ µ3UREOHP UHVROXWLRQ 'HVLJQ Updated in Bentley, 7D[SD\HUV¶ 5LJKWV *and Implementation*, above n 10, ch 5. 7KH 6\VWHP 2SHUDFK UHV

[40] Mookhey, above n 25.

[41] Ury, Brett and Goldberg, above n 10, 42.

[42] -RQH µ(YDOXDWLQJ $XVWUDOLD¶V WD[GLVSXWH UHVROXWLRQ V\ above n 25; Jone, µ(YDOXDWLQJ 1HZ =HDODQG¶V WD[GLVSXWH UHVROXWLRQ SHUVSHFWLYH 3H ¶- RQH EHQFKPDUN µHKQW FDQ WKH 8QLWHG .LQJGRP¶V 7D['LVS

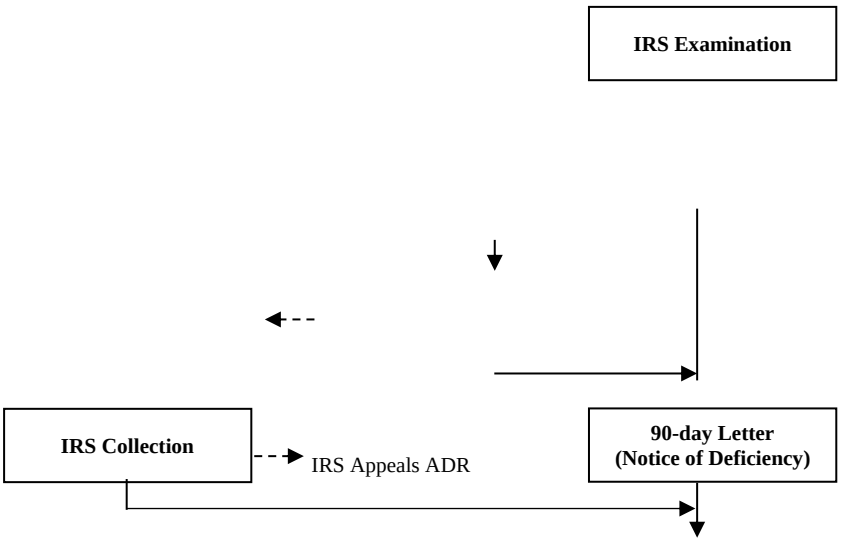
Nevertheless, it should be noted that the DSD principles in Table 1 are expressed in the

is, chooses to bypass the IRS Appeals system), a 90-day letter (Notice of Deficiency) is issued by the IRS.

- The taxpayer has 90 days (150 days if it is addressed to a taxpayer outside the US) from the date of the 90-day letter to file a petition with the US Tax Court, the US District Court or the US Court of Federal Claims.

In addition, as indicated in Figure 1, the IRS Appeals Office offers a number of ADR programs for certain types of taxpayers to resolve tax disputes during the examination, appeals and collection stages of the dispute resolution process (see section 3.2 below for disputes heard by the US Tax Court, ADR processes (arbitration or mediation) are also potentially available.[48] The Taxpayer Advocate Service (TAS) provides an additional avenue for taxpayers to resolve problems with the IRS which they have been unable to resolve themselves.[49] As indicated in Figure 1, the TAS is available alongside the traditional dispute resolution process.

Fig. 7KH 8QLWHG 6WDWHV Tax Dispute Resolution Procedures



[48] See Internal Revenue Manuals (IRM) 35.5.5.
[49] See Taxpayer Advocate Service, https://taxpayeradvocate.irs.gov/.

but are not limited to, the Accelerated Issue Resolution (AIR) program,[60] Delegation Order 4-24[61] and Delegation Order 4-25.[62] These IRS dispute resolution initiatives do not fall within the definition of ADR primarily because they do not specifically involve an impartial third party assisting those in dispute to resolve the issues between them.[63] For example, the AIR program involves an agreement between the IRS and certain qualifying taxpayers to advance the resolution of issues arising from an audit of the taxpayer from one or more tax periods, to other tax periods ending prior to the date of that agreement.[64]

4. DISPUTE SYSTEMS DESIGN EVALUATION OF THE SYSTEM

This section evaluates the US tax dispute resolution procedures utilising the 14 DSD principles outlined in Table 1 in section 2 of this article.

4.1 DSD Principle 1: stakeholders are included in the design process

The IRS involves taxpayers and other stakeholders in the design process through its pilot programs of IRS ADR processes and its requests for stakeholder submissions on proposed or revised versions of IRS revenue procedures and other forms of IRS guidance. The Taxpayer Advocacy Panel (TAP),[65] a Federal Advisory Committee to the IRS which OLVWHQV WR WD[SD\HUV LGHQWLILHV WD[SD\HU improving IRS service and customer satisfaction, may also provide a means for taxpayers to submit suggestions to the IRS in relation to the disputes process and its design. In addition, the IRS Oversight Board engages with a wide variety of stakeholders to understand their views on tax administration and its impact on taxpayers.[66] It interacts regularly with external groups which include tax professionals, taxpayer advocacy groups, representatives of state tax departments, IRS advisory committees, IRS employees, the National Treasury Employees Union, and other groups that have an interest in tax administration. Thus, these groups can provide input in the design process of the system through these interactions.

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[60] See Internal Revenue Service, Rev. Proc. 94-67, 1994- & % µ5HY- 3¶URF

[61] See IRM 1.2.43.22.

[62] See IRM 1.2.43.23.

[63] Although, for the purposes of this article, these IRS dispute resolution initiatives may be viewed as µORRS IRUZDUG PHFKDQLVPV (discussed under DSD Principle 3 in section 2, Table 1 of this article).

[64] Internal Revenue Service, µ5HY 3UR¶ DER 68. HQ Delegation Order 4-24 provides IRS Examination case managers settlement authority on recurring issues for a taxpayer, provided that the issues were settled in IRS Appeals for the same taxpayer or another taxpayer directly involved in the same transaction in a prior or later period: IRM 1.2

4.2 DSD Principle 2: the system has multiple options for addressing conflict including interests, rights and power-based processes

As indicated in section 3, the US tax dispute resolution system has multiple options for addressing conflict. The procedures provide for initial negotiations between the WD[SD\HU DQG WKH ,56 H[DPLQHU DQG RU WKH H[DPLQ IRS examination. If the dispute remains unresolved, the taxpayer may appeal their case WR WKH ,56 $SSHDOV 2IILFH WKH ,56¶V LQWHUQDO U scheduled so that the taxpayer and the IRS can attempt to negotiate a mutually acceptable settlement. If the dispute cannot be resolved at the IRS Appeals Office level (or the taxpayer chooses to bypass the IRS Appeals Office), taxpayers may pursue rights-based litigation processes by filing a petition in either the US Tax Court, US District Court or the US Court of Federal Claims.

4.4 DSD Principle 4: there is notification before and feedback after the resolution process

The US tax dispute resolution system provides certain forms of notification before and feedback after the resolution process. Notification is built into the dispute resolution SURFHVV WKURXJK WKH ,56¶V 7D[SD\HU %LOO RI 5LJKWV
p
the right to be informed about IRS decisions about their tax accounts and to receive clea U H[SODQDWLRQV[69] Taxpayers also have the right to know the PD[LPXP DPRXQW RI WLPH WKH\ KDYH[70] WR FKDOOHQJH

7D[SD\HU %LOO RI 5LJKWV SURYLVLRQV SURYLGLQJ I
and referring taxpayers to

prior DSD evaluations conducted by the author, it may be a common feature of tax disputes resolution systems in general.[81] This is because, given the arguably complex nature of many tax disputes, taxpayers are required to work out their positions from the outset and, as a consequence, may require professional advice and assistance (which involves incurring related costs) in order to do so.[82]

4.7 DSD Principle 7: the system has multiple access points

The disputes process haess

F R U P V D Q G S X E O L F D W L R Q V R Q W D [D S S H D O U L[86] The IRS further has a webpage, *Appeals Mediation Programs: Alternative Dispute Resolution (ADR)*, which provides education and guidance for taxpayers and other stakeholders on the Appeals mediation programs.

taxpayers in choosing the best process.[96] The Appeals Online Self-Help Tools can be used by taxpayers to determine whether they would benefit from filing an appeal and the Appeals Mediation Online Self-Help Tool can be used to determine whether there is an appropriate IRS ADR program that may be utilised to help resolve disputes.

IRS revenue procedures on the IRS ADR programs and the IRM provide guidance for IRS officers and taxpayers on, *inter alia*, case eligibility and case exclusions from the ADR programs.[97] The IRS ADR programs may be requested by either the taxpayer or the IRS after consulting with the other party. However, IRS Appeals Managers generally act as process advisers to ensure the appropriate use of the ADR programs.[98]

4.10 DSD Principle 10: disputants have the right to choose a preferred process

As indicated under DSD Principle 7 in section 4.7, taxpayers have the right to choose a preferred process in the respect that they can choose to enter the disputes process at either the IRS Appeals Office level or at the level of the US Tax Court. Also, for taxpayers with small tax cases there are further opportunities to choose a preferred process in the respect that if certain criteria are met, qualifying taxpayers may choose to file a small case request (thus, following simplified filing requirements) instead of filing a formal protest with the IRS Appeals Office. In addition, at the level of the US Tax Court, taxpayers with qualifying small tax cases may request that their case be handled by the simpler, less formal small case procedures instead of the regular US Tax Court procedures.

Taxpayers also have the right to choose a preferred process in the respect that they are able to select between the formal disputes process and various IRS ADR programs available at the examination and appeals stages of the disputes process. As outlined in section 3.2, for certain ADR programs utilised at the examination (pre-Appeals) stage of the formal disputes process (for example, FTS), if an agreement (in whole or in part) is unable to be reached through ADR, the taxpayer retains all of their otherwise applicable appeal rights to request traditional IRS Appeals consideration of unresolved issues.[99]

At the level of the US Tax Court taxpayers can choose a preferred process in the respect that before commencing any formal court proceedings, parties may choose to utilise US Tax Court arbitration or mediation where appropriate. If arbitration is entered into, the DUELWUDWRU¶V GHFLVLRQ LV ELQGLQJ unless the parties reach an agreement through mediation, the parties may preoW* nm Tm0 W* nm Tm0 W* nm Tm0 W* nm T

Nevertheless, personal correspondence by the author with a number of US practitioners indicates the existence of generally positive perceptions of the IRS Appeals Office in effectively resolving disputes.[108] Historically IRS Appeals have settled 90 to 95 per cent

,56¶V H[LVWLQJ $'5 WRROV 7KLV ZDV DOVR FRQGXFWHG RQ WKH ,56 $SSHDOV
2IILFH¶V $'5 SURJUDPV WR LGHQWLI\ SRWHQWLDO RSS

For evaluation conducted on the IRS Appeals [129]

The Taxpayer Advocacy Panel may also provide a means through which evaluation of the dispute resolution system can occur as it conducts outreach to solicit suggestions or ideas from citizens, and serves on project committees working with IRS program owners on topics imp RUWDQW WR WD[SD\HUV DQG WKH ,56 7K Congress may provide a form of evaluation of the system to the extent that problems relating to the IRS Appeals Office and its processes are identified and consequent legislative and/or administrative changes may be recommended. The IRS Oversight Board may further provide an evaluation of aspects of the dispute resolution system through its annual reports to Congress and other special reports issued. Federal oversight organisations such as the US Government Accountability Office (GAO) and the Treasury Inspector-General for Tax Administration (TIGTA) have also provided reports on the IRS Appeals Office and its processes.

5. DISCUSSION AND RECOMMENDATIONS FROM AUSTRALIA

The dispute systems design evaluation conducted above in section 4 indicates that the US tax dispute resolution system follows many of the DSD principles of best practice derived from the DSD literature, including: (i) involving stakeholders in the design process; (ii) providing multiple options for addressing conflict; (iii) the provision of loop-back and loop-forward mechanisms; (iv) allowing for notification before and feedback after the dispute resolution process; (v) the inclusion of internal independent confidential neutrals in the system; (vi) the ordering of the procedures from low to high cost (notwithstanding the high upfront costs generally incurred by taxpayers in tax disputes); (vii) provision of multiple access points to the system; (viii) the provision of forms of training and education for stakeholders; (ix) assistance for choosing the best process; (x) offering disputants the right to choose a preferred process, and (xi) the presence of evaluation of the system.

Nevertheless, the US tax dispute resolution system also has some DSD deficiencies. There appears to be limited visible evidence of the support and championship of the dispute resolution system by certain members of IRS top management, namely the Commissioner of the IRS. Moreover, with respect to the support and championship of ADR in the system, it appears that the IRS has been reluctant to fully embrace ADR, in part due to the relative success of the well-established procedures of the IRS Appeals Office. There is also an apparent absence of the dispute resolution system and ADR IURP WKH ,56 *UHDWHU $FFHVV DQG WKH 1HZ IRS Future State initiative.

There has also been some evidence of negative perceptions of fairness of the tax dispute resolution system. These have largely related to concerns by internal and external stakeholders on the independence and impartiality of determinations made by the IRS Appeals Office. In addition, notwithstanding that there are mechanisms present in the

satisfaction surveys, a further deficiency in the system appears to be the limited publication of the feedback collected.

It thus follows that the DSD evaluation conducted indicates that the strengths of the US tax dispute resolution system lie in various structural aspects of the system design such as providing multiple options for addressing conflict, multiple entry points to the system and loops backwards and forwards in the procedures. Furthermore, a notable feature of the system is the availability of the independent TAS within the IRS, which provides an avenue for taxpayers supplementing the traditional dispute resolution process. Notwithstanding these structural strengths, the US dispute resolution system is deficient in certain aspects pertaining to the support and championship of the system, the integration of the dispute resolution system within the wider tax administration and the reporting of feedback on the system. In seeking to improve the tax dispute resolution procedures in these particular areas, there are a number of design features which the US could potentially consider drawing upon from the Australian tax dispute resolution system.

As noted in section 1, Australia is widely regarded as one of the leaders in best practice tax administration.[130] Moreover, given that the Australian tax dispute resolution system has previously been evaluated in the DSD context, it arguably provides suitable guidance on the DSD strengths and weaknesses which may exist in the context of tax dispute resolution. 7KH PLVVLRQ RI contribute to the economic and social well

corporate plans.[147] 7KH $72¶V DQQXDO UHSRUWV DOVR LQFOXG
reports RQ resolving disputes ¶

of the IRS ADR programs as well as the seeming reluctance of IRS staff to depart from the established procedures of the Appeals Office, training/awareness sessions on the benefits of ADR could be provided to various frontline IRS staff in order to raise the internal profile of ADR. Notwithstanding that there is evidence of some external promotion of ADR by the IRS Chief of Appeals, in order to raise greater external awareness of its ADR programs, the IRS could undertake to further promote its ADR programs to key external stakeholders including the legal and accountancy professions and large and smaller accountancy firms.

harder to resolve their problems with the IRS.[158] As a consequence, confidence in the fairness of the tax system may erode, and taxpayer frustration and alienation may lead over time to a lower rate of voluntary compliance.[159] These concerns have been discussed extensively in a series of public forums held by the NTA on the Future State initiative.[160] It is not realistic to expect that taxpayers who are told they owe more tax or whose refunds have been significantly delayed are going to be satisfied resolving their problems with the IRS exclusively through an online account.[161] A high percentage of taxpayers in this situation will want to speak with an IRS employee so they can be certain they understand the source of the problem and what more they need to do ² and try to obtain reassurance about when they can expect a final resolution.[162]

Ultimately, the IRS must work within whatever budget it is given. Nevertheless, the IRS should be clear in communicating to Congress about the difficult choices it is facing. If the IRS implies that the adoption of online accounts will enable it to do a better job of meeting taxpayer needs at lower cost (through reduced personal interaction), Congress will have no reason to give the agency more funding. If the IRS can warn that online accounts, while desirable in many ways, will not be sufficient to address most taxpayer needs, Congress will be better informed about the tradeoffs that must be made.

The encouragement and promotion of ADR by the IRS may also be made more complex due to existing stakeholder perceptions of the IRS. In recent times IRS officials have faced scrutiny by the media,

improvements to the system drawing upon DSD features of the tax dispute resolution V\VWHP LQ $XVWUDOLD DQG WKH 1HWKHUODQGV IRUPDWLRQ SURMHF

The DSD evaluation conducted indicates that the US tax dispute resolution system meets many of the DSD principles of best practice. Its particular strengths lie in the structural aspects of design, including providing multiple options for dispute resolution, multiple entry points to the system and loops backwards and forwards in the procedures. However, it is deficient in a number of areas which largely relate to the support and championship of the dispute resolution system and ADR by certain members of the IRS, the integration of the system and ADR within the wider tax administration and the reporting of feedback collected on the system.

Accordingly, drawing from certain practices and experiences of the Australian tax dispute resolution system, this article recommends that the US tax dispute resolution