

impact, positive or negative, on a substantial number of small entities under the criteria of the Regulatory Flexibility Act. A final evaluation has been prepared for this action and it is contained in the Rules Docket. A copy of it may be obtained from the Rules Docket at the location provided under the caption ADDRESSES.

List of Subjects in 14 CFR Part 39

Air transportation, Aircraft, Aviation safety, Incorporation by reference, Safety.

Adoption of the Amendment

Accordingly, pursuant to the authority delegated to me by the Administrator, the Federal Aviation Administration amends 14 CFR part 39 of the Federal Aviation Regulations as follows:

PART 39—AIRWORTHINESS DIRECTIVES

1. The authority citation for part 39 continues to read as follows:

Authority: 49 U.S.C. App. 1354(a), 1421 and 1423; 49 U.S.C. 106(g); and 14 CFR 11.89.

§ 39.13 [Amended]

2. Section 39.13 is amended by adding the following new airworthiness directive:

94-11-08 Jetstream Aircraft Limited:
Amendment 39-8924. Docket 93-NM-199-AD.

Applicability: Model 4101 airplanes; constructors numbers 41004 through 41018 inclusive, certificated in any category.

Compliance: Required as indicated, unless accomplished previously.

To prevent reduced controllability of the airplane, accomplish the following:
(a) Within 3 months after the effective date of this AD, modify the aileron drive quadrant support structure below the flight compartment floor in accordance with Jetstream Service Bulletin J41-53-011, dated October 15, 1993.

(b) An alternative method of compliance or adjustment of the compliance time that provides an acceptable level of safety may be used if approved by the Manager, Standardization Branch, ANM-113, FAA, Transport Airplane Directorate. Operators shall submit their requests through an appropriate FAA Principal Maintenance Inspector, who may add comments and then send it to the Manager, Standardization Branch, ANM-113.

Note: Information concerning the existence of approved alternative methods of compliance with this AD, if any, may be obtained from the Standardization Branch, ANM-113.

(c) Special flight permits may be issued in accordance with sections 21.197 and 21.199 of the Federal Aviation Regulations (14 CFR 21.197 and 21.199) to operate the airplane to

a location where the requirements of this AD can be accomplished.

(d) The modification shall be done in accordance with Jetstream Service Bulletin J41-53-011, dated October 15, 1993. This incorporation by reference was approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR Part 51. Copies may be obtained from Jetstream Aircraft, Inc., P.O. Box 16029, Dulles International Airport, Washington, DC 20041-6029. Copies may be inspected at the FAA, Transport Airplane Directorate, 1601 Lind Avenue, SW., Renton, Washington; or at the Office of the Federal Register, 800 North Capitol Street, NW., suite 700, Washington, DC.

(e) This amendment becomes effective on July 7, 1994.

Issued in Renton, Washington, on May 25, 1994.

Darrell M. Pederson,

Acting Manager, Transport Airplane Directorate, Aircraft Certification Service.

[FR Doc. 94-13237 Filed 6-6-94; 8:45 am]

BILLING CODE 4910-13-U

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 301

[TD 8543]

RIN 1545-AS60

Exhaustion of Administrative Remedies

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains the final regulations relating to the circumstances in which a party shall be deemed to have exhausted the administrative remedies available within the Internal Revenue Service for purposes of the recovery of court costs and certain fees in a civil tax proceeding brought in a court of the United States (including the Tax Court and the Court of Federal Claims). These regulations differ from the final regulations previously issued under section 7430, which were effective for civil tax proceedings commenced after February 28, 1983, and before January 1, 1986, and addressed the exhaustion of administrative remedies requirement for recovery of litigation costs incurred by taxpayers with respect to a court proceeding in connection with the determination, collection, or refund of any tax, interest, or penalty. Portions of the final regulations previously issued under section 7430 were held to be invalid by the United States Tax Court in *Minahan v. Commissioner*, 88 T.C.

492 (1987). This regulation does not contain those provisions of the previous final regulation found to be invalid.

DATES: The final regulations are effective June 7, 1994, and apply to court proceedings described in section 7430 filed in a court of the United States (including the Tax Court and the Court of Federal Claims) after May 7, 1992.

FOR FURTHER INFORMATION CONTACT:

Thomas D. Moffitt of the Office of Assistant Chief Counsel (Field Service), Internal Revenue Service, (202) 622-7900 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

Proposed amendments to the Income Tax Regulations (26 CFR part 301) under section 7430 of the Internal Revenue Code (the Code) were published in the *Federal Register* on May 8, 1992 (57 FR 19828 [IA-003-89, 1992-1 C.B. 1100]). The amendments were issued under the authority contained in section 7805 of the Code.

One public comment was received concerning these regulations. After consideration of the public comment received, the proposed regulations are adopted, as revised by this Treasury decision.

Explanation of Regulatory Provisions

In general, under section 7430 of the Code, a prevailing party may recover the reasonable litigation costs incurred in a civil proceeding if the proceeding relates to the determination, collection or refund of any tax, interest or penalty under the Internal Revenue Code and the party has exhausted all the administrative remedies related to that party's tax matter. These final regulations provide information concerning the circumstances in which a party's administrative remedies shall be deemed to have been exhausted. In general, administrative remedies are deemed to have been exhausted if the party has requested (and if granted, participated in) an Appeals office conference on the party's tax matter prior to filing an action in a court of the United States (including the Tax Court and the Court of Federal Claims). A party has participated in an Appeals office conference if the party has disclosed all relevant information regarding the matter to the Appeals office. In the case of the revocation of a determination that an organization is described in section 501(c)(3), a party must complete the procedures set forth in section 7428 and in regulations, rules and revenue procedures thereunder to exhaust its administrative remedies. Where no administrative procedure

covering a party's tax matter allows the party to request an Appeals office conference, the party's administrative remedies will not be deemed to have been exhausted unless the party has filed a written claim for relief with the district director having jurisdiction over the tax matter and allowed the district director a reasonable period of time to act on the claim. A party is not required to pursue its administrative remedies if the Internal Revenue Service has notified the party in writing that such pursuit is unnecessary, has not given the party an opportunity to request an Appeals office conference before sending a statutory notice of deficiency, or has failed to grant the party an Appeals office conference with respect to a claim for refund within six months of the filing of such claim for refund. A party must participate in an Appeals office conference during either the deficiency procedures or the refund procedures with respect to the tax matter, but is not required to participate during both procedures. Thus, if a party participated in an Appeals office conference with respect to a tax matter prior to the issuance of the statutory notice of deficiency, the party does not need to request an Appeals office conference after filing a claim for refund with respect to the same tax matter.

Comments on the Proposed Regulations

One public comment objected to, and requested deletion of, the requirement that a party request (and if granted, participate in) an Appeals office conference on the party's tax matter prior to filing an action in a court of the United States (including the Tax Court and the Court of Federal Claims). This suggestion was not adopted in the final regulations because conferences with Appeals have historically been a fundamental method for providing administrative remedies to taxpayers who do not agree with the Internal Revenue Service. Such remedies are pivotal to the effort to resolve issues promptly, efficiently, fairly and without resort to litigation. In order to avoid costly litigation consistent with the legislative intent and to encourage usage of this process to resolve disputes, the regulations require taxpayers, in order to be deemed to have exhausted their administrative remedies, to pursue such remedies with the Appeals office, if available, prior to instituting litigation.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It has also

been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Thomas D. Moffitt, Office of Assistant Chief Counsel (Field Service), Internal Revenue Service. However, other personnel from the Service and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 301

Employment taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements, State taxes.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 301.7430-1 is revised to read as follows:

§ 301.7430-1 Exhaustion of administrative remedies.

(a) *In general.* Section 7430(b)(1) provides that a court shall not award reasonable litigation costs in any civil tax proceeding under section 7430(a) unless the court determines that the prevailing party has exhausted the administrative remedies available to the party within the Internal Revenue Service. This section sets forth the circumstances in which such administrative remedies shall be deemed to have been exhausted.

(b) *Requirements—(1) In general.* A party has not exhausted the administrative remedies available within the Internal Revenue Service with respect to any tax matter for which an Appeals office conference is available under §§ 601.105 and 601.106 of this chapter (other than a tax matter described in paragraph (c) of this section) unless—

(i) The party, prior to filing a petition in the Tax Court or a civil action for refund in a court of the United States (including the Court of Federal Claims), participates, either in person or through a qualified representative described in

§ 601.502 of this chapter, in an Appeals office conference; or

(ii) If no Appeals office conference is granted, the party, prior to the issuance of a statutory notice in the case of a petition in the Tax Court or the issuance of a notice of disallowance in the case of a civil action for refund in a court of the United States (including the Court of Federal Claims)—

(A) Requests an Appeals office conference in accordance with §§ 601.105 and 601.106 of this chapter; and

(B) Files a written protest if a written protest is required to obtain an Appeals office conference.

(2) *Participates.* For purposes of this section, a party or qualified representative of the party described in § 601.502 of this chapter participates in an Appeals office conference if the party or qualified representative discloses to the Appeals office all relevant information regarding the party's tax matter to the extent such information and its relevance were known or should have been known to the party or qualified representative at the time of such conference.

(3) *Tax matter.* For purposes of this section, "tax matter" means a matter in connection with the determination, collection or refund of any tax, interest, penalty, addition to tax or additional amount under the Internal Revenue Code.

(c) *Revocation of a determination that an organization is described in section 501(c)(3).* A party has not exhausted the administrative remedies available within the Internal Revenue Service with respect to a revocation of a determination that it is an organization described in section 501(c)(3) unless, prior to filing a declaratory judgment action under section 7428, the party has exhausted its administrative remedies in accordance with section 7428, and any regulations, rules, and revenue procedures thereunder.

(d) *Actions involving summonses, levies, liens, jeopardy and termination assessments, etc.* (1) A party has not exhausted the administrative remedies available within the Internal Revenue Service with respect to a matter other than one to which paragraph (b) or (c) of this section applies (including summonses, levies, liens, and jeopardy and termination assessments) unless, prior to filing an action in a court of the United States (including the Tax Court and the Court of Federal Claims)—

(i) The party submits to the district director of the district having jurisdiction over the dispute a written claim for relief reciting facts and circumstances sufficient to show the

nature of the relief requested and that the party is entitled to such relief; and

(ii) The district director has denied the claim for relief in writing or failed to act on the claim within a reasonable period after such claim is received by the district director.

(2) For purposes of this paragraph (d)(2), a reasonable period is—

(i) The 5-day period preceding the filing of a petition to quash an administrative summons issued under section 7609;

(ii) The 5-day period preceding the filing of a wrongful levy action in which a demand for the return of property is made;

(iii) The period expressly provided for administrative review of the party's claim by an applicable provision of the Internal Revenue Code that expressly provides for the pursuit of administrative remedies (such as the 16-day period provided under section 7429(b)(1)(B) relating to review of jeopardy assessment procedures); or

(iv) The 60-day period following receipt of the claim for relief in all other cases.

(e) *Exception to requirement that party pursue administrative remedies.* If the conditions set forth in paragraph (e)(1), (e)(2), (e)(3), or (e)(4) of this section are satisfied, a party's administrative remedies within the Internal Revenue Service shall be deemed to have been exhausted for purposes of section 7430.

(1) The Internal Revenue Service notifies the party in writing that the pursuit of administrative remedies in accordance with paragraphs (b), (c), and (d) of this section is unnecessary.

(2) In the case of a petition in the Tax Court—

(i) The party did not receive a notice of proposed deficiency (30-day letter) prior to the issuance of the statutory notice and the failure to receive such notice was not due to actions of the party (such as a failure to supply requested information or a current mailing address to the district director or service center having jurisdiction over the tax matter); and

(ii) The party does not refuse to participate in an Appeals office conference while the case is in docketed status.

(3) In the case of a civil action for refund involving a tax matter other than a tax matter described in paragraph (e)(4) of this section, the party—

(i) Participates in an Appeals office conference with respect to the tax matter prior to issuance of a statutory notice of deficiency with respect to such tax matter; or

(ii) Did not receive written notification that an Appeals office conference was available prior to issuance of a notice of disallowance and the failure to receive such a notification was not due to the actions of the party (such as the failure to supply requested information or a current mailing address to the district director or service center having jurisdiction over the tax matter); or

(iii) Did not receive either written or oral notification that an Appeals office conference had been granted within six months from the date of the filing of the claim for refund and the failure to receive such notice was not due to actions of the party (such as the failure to supply requested information or a current mailing address to the district director or service center having jurisdiction over the tax matter).

(4) In the case of a civil action for refund involving a tax matter under sections 6703 or 6694—

(i) The party did not receive a notice of proposed disallowance prior to issuance of a notice of disallowance and the failure to receive such notice was not due to actions of the party (such as the failure to supply requested information or a current mailing address to the district director or service center having jurisdiction over the tax matter); or

(ii) During the six-month period following the day on which the party's claim for refund is filed, the party's claim for refund is not denied, and the Internal Revenue Service has failed to process the claim with due diligence.

(f) *Examples.* The provisions of this section may be illustrated by the following examples:

Example 1. Taxpayer A exchanges property held for investment for similar property and claims that the gain on the exchange is not recognized under section 1031. The Internal Revenue Service conducts a field examination and determines that there has not been a like-kind exchange. No agreement is reached on the matter and a notice of proposed deficiency (30-day letter) is sent to A. A does not file a request for an Appeals office conference. A pays the amount of the proposed deficiency and files a claim for refund. A notice of proposed disallowance is issued by the Internal Revenue Service. A does not request an Appeals office conference and, instead, files a civil action for refund in a United States District Court. A has not exhausted the administrative remedies available within the Internal Revenue Service.

Example 2. Assume the same facts as in *Example 1* except that, after receiving the notice of proposed deficiency (30-day letter), A files a request for an Appeals office conference. No agreement is reached at the conference. A pays the amount of the proposed deficiency and files a claim for

refund. A notice of proposed disallowance is issued by the Internal Revenue Service. A does not request an Appeals office conference and files a civil action for refund in a United States District Court. A has exhausted the administrative remedies available within the Internal Revenue Service.

Example 3. Assume the same facts as in *Example 1* except A first requests an Appeals office conference after A's receipt of the notice of proposed disallowance. A is granted an Appeals office conference and A participates in such conference. A has exhausted the administrative remedies available within the Internal Revenue Service.

Example 4. Taxpayer B receives a notice of proposed deficiency (30-day letter) after completion of a field examination. B provided to the Internal Revenue Service during the examination all relevant information under the taxpayer's control and all relevant legal arguments supporting the taxpayer's position. B properly requests an Appeals office conference. The Appeals office, to obtain an additional period of time to consider the tax matter, requests that B sign Form 872 to extend the time for an assessment of tax, but B declines. Appeals then denies the request for a conference and issues a notice of deficiency. B has exhausted the administrative remedies available within the Internal Revenue Service.

Example 5. Taxpayer C receives a notice of proposed deficiency (30-day letter) and a written statement that C need not file a written protest or request an Appeals office conference since a conference will not be granted. C files a petition in the Tax Court after receiving the statutory notice of deficiency. C's administrative remedies within the Internal Revenue Service are deemed to have been exhausted.

Example 6. On January 2, the Internal Revenue Service serves a summons issued under section 7609 on third-party recordkeeper D to produce records of taxpayer E. On January 5, notice of the summons is given to E. The last day on which E may file a petition in a court of the United States to quash the summons is January 25. Thereafter, E files a written claim for relief with the district director having jurisdiction over the matter together with a copy of the summons. The claim and copy are received by the district director on January 20. On January 25, E files a petition to quash the summons. E has exhausted the administrative remedies available within the Internal Revenue Service.

Example 7. A notice of Federal tax lien is filed in County M on March 3, in the name of F. On April 2, F pays the entire liability thereby satisfying the lien. On May 2, F files a written claim with the district director having jurisdiction over the tax matter demanding a certificate of release of lien. Thereafter, F provides the district director with a copy of the notice of Federal tax lien and a copy of the canceled check in satisfaction of the lien, which are received by the district director on May 15. F's claim is deemed to have been filed on May 15. Accordingly, F must wait until after July 14 (60 days following the filing of the claim for

relief on May 15) to commence an action, in order to have exhausted the administrative remedies available within the Internal Revenue Service.

Example 8. A revenue officer seizes an automobile to effect collection of G's liability on January 10. On January 22, H submits a written claim to the district director having jurisdiction over the tax matter claiming that H purchased the automobile from G for an adequate consideration before the tax lien against G arose, and demands immediate return of the automobile. A copy of the title certificate and H's canceled check are submitted with the claim. The claim is received by the district director on January 25. On January 30, H brings a wrongful levy action. H has exhausted the administrative remedies available within the Internal Revenue Service.

Example 9. The Internal Revenue Service issues a revenue ruling which holds that ear piercing does not affect a function or structure of the body within the meaning of section 213 and therefore is not deductible. Taxpayer I deducts the costs of ear piercing and, following an examination, receives a notice of proposed deficiency (30-day letter) disallowing the treatment of such costs. Because of the revenue ruling, I believes a conference would not aid in the resolution of the tax dispute. Accordingly, I does not request an Appeals office conference. After receiving a statutory notice of deficiency, I files a petition in the Tax Court. I has not exhausted the administrative remedies available within the Internal Revenue Service. The issuance of a revenue ruling covering the same fact situation but taking a contrary position does not constitute notification by the Internal Revenue Service to I that the pursuit of administrative remedies is unnecessary. Similarly, the issuance to I of a private letter ruling or technical advice does not constitute notification by the Internal Revenue Service that the pursuit of administrative remedies is unnecessary.

Example 10. Taxpayer J is assessed a penalty under section 6701 for aiding in the understatement of the tax liability of another person. J pays 15% of the penalty in accordance with section 6703 and files a claim for refund on June 15. J is not issued a notice of proposed disallowance and thus cannot participate in an Appeals office conference within six months of the filing of the claim for refund. J brings an action on December 23. J has exhausted the administrative remedies available within the Internal Revenue Service.

Example 11. Taxpayer K receives a notice of proposed deficiency (30-day letter) and neither requests nor participates in an Appeals office conference. The Service then issues a statutory notice of deficiency (90-day letter). Upon receiving the statutory notice, and after filing a petition with the Tax Court, K requests an Appeals office conference. K has not exhausted the administrative remedies available within the Internal Revenue Service because the request for an Appeals office conference was made after the issuance of the statutory notice.

(g) **Effective date.** This section applies to court proceedings described in

section 7430 filed in a court of the United States (including the Tax Court after May 7, 1992).

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved: May 9, 1994.

Leslie Samuels,
Assistant Secretary of the Treasury.
[FR Doc. 94-12827 Filed 6-6-94; 8:45 am]
BILLING CODE 4830-01-U

26 CFR Parts 301 and 602

[TD 8542]

RIN 1545-AN02

Recovery of Reasonable Administrative Costs

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains the final regulations relating to the recovery of reasonable administrative costs incurred by taxpayers in connection with an administrative proceeding within the Internal Revenue Service. Changes to the applicable law were made by section 6239(a) of the Technical and Miscellaneous Revenue Act of 1988 (TAMRA) (Pub. L. No. 100-647, 102 Stat. 3342). These regulations affect all taxpayers involved in an administrative proceeding within the Internal Revenue Service, and provide guidance regarding the definition of reasonable administrative costs and the period within which the costs must be incurred in order to be recoverable. These regulations also set forth the requirements and procedures for the recovery of such costs, and the definitions of prevailing party, administrative proceeding and administrative proceeding date. A table of contents to the regulations under section 7430 is provided in § 301.7430-0.

DATES: Sections 301.7430-0 and 301.7430-2 through 301.7430-6, except for § 301.7430-2(c)(5), are effective June 7, 1994, and apply to claims for reasonable administrative costs filed with the Internal Revenue Service after December 23, 1992, with respect to costs incurred in administrative proceedings commenced after November 10, 1988. Section 301.7430-2(c)(5) is effective March 23, 1993. The amendment to part 602 is effective June 7, 1994.

FOR FURTHER INFORMATION CONTACT: Thomas D. Moffitt of the Office of Assistant Chief Counsel (Field Service), Internal Revenue Service, (202) 622-7900 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act (44 U.S.C. 3504(h)) under control number 1545-1356. The estimated average annual burden per respondent is 120 minutes.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, PC:FP, Washington, DC 20224, and to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Background

Proposed additions to the Income Tax Regulations (26 CFR Part 301) under section 7430 of the Internal Revenue Code (the Code) were published in the Federal Register on December 23, 1992 (57 FR 61020 [IA-003-89, 1993-1 C.B. 789]). These proposed additions were issued under the authority contained in section 7805 of the Code. A summary of the proposed additions is contained in the preamble that was published with the proposed additions.

Changes to the Proposed Regulations

No changes have been made to the proposed regulations. One public comment objected to the failure of the regulations to provide for the recovery of amounts expended by taxpayers during the examination of their returns. As section 7430 does not provide for such awards, this suggestion was not adopted. After consideration of the public comment received, the proposed regulations are adopted as revised by this Treasury decision.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small

Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Thomas D. Moffitt, Office of Assistant Chief Counsel (Field Service), Internal Revenue Service. However, other personnel from the Internal Revenue Service and Treasury Department participated in their development.

List of Subjects

26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 301 and 602 are amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *.

Par. 2. Sections 301.7430-0 and 301.7430-2 through 301.7430-6 are added to read as follows:

§ 301.7430-0 Table of contents.

This section lists the captions that appear in §§ 301.7430-1 through 301.7430-6.

§ 301.7430-1 Exhaustion of administrative remedies.

- (a) In general.
- (b) Requirements.
 - (1) In general.
 - (2) Participates.
 - (3) Tax matter.
- (c) Revocation of a determination that an organization is described in section 501(c)(3).
- (d) Actions involving summonses, levies, liens, jeopardy and termination assessments, etc.
- (e) Exception to requirement that party pursue administrative remedies.
- (f) Examples.
- (g) Effective date.

§ 301.7430-2 Requirements and procedures for recovery of reasonable administrative costs.

- (a) Introduction.
- (b) Requirements for recovery.
 - (1) Determination by the Internal Revenue Service.
 - (i) Jurisdiction.
 - (ii) Administrative proceeding.

- (iii) Administrative proceeding date.
- (iv) Reasonable administrative costs.
- (v) Prevailing party.
- (vi) Not unreasonably protracted.
- (vii) Procedural requirements.
- (2) Determination by court.
- (c) Procedure for recovering reasonable administrative costs.
 - (1) In general.
 - (2) Where request must be filed.
 - (3) Contents of request.
 - (i) Statements.
 - (ii) Affidavit or affidavits.
 - (iii) Documentation and information.
 - (4) Form of request.
 - (5) Period for requesting costs from the Internal Revenue Service.
 - (6) Notice.
 - (7) Appeal to Tax Court.
 - (d) Unreasonable protraction of administrative proceeding.
 - (e) Examples.

§ 301.7430-3 Administrative proceeding and administrative proceeding date.

- (a) Administrative proceeding.
- (b) Collection action.
- (c) Administrative proceeding date.
 - (1) General rule.
 - (2) Notice of the decision of the Internal Revenue Service Office of Appeals.
 - (3) Notice of deficiency.
 - (d) Examples.

§ 301.7430-4 Reasonable administrative costs.

- (a) In general.
- (b) Costs described.
 - (1) In general.
 - (2) Representative and specially qualified representative.
 - (i) Representative.
 - (ii) Specially qualified representative.
 - (3) Limitation on fees for a representative.
 - (i) In general.
 - (ii) Cost of living adjustment.
 - (iii) Special factor adjustment.
 - (c) Certain costs excluded.
 - (1) Costs not incurred in an administrative proceeding.
 - (2) Costs incurred in an administrative proceeding but not reasonable.
 - (i) In general.
 - (ii) Special rule for expert witness' fees on issue of prevailing market rates.
 - (3) Litigation costs.
 - (d) Examples.

§ 301.7430-5 Prevailing party.

- (a) In general.
- (b) Position of the Internal Revenue Service.
- (c) Substantially justified.
 - (1) In general.
 - (2) Exception.
 - (d) Amount in controversy.
 - (e) Most significant issue or set of issues presented.
 - (f) Net worth and size limitations.
 - (1) Individuals and estates.
 - (2) Others.
 - (3) Special rule for charitable organizations and certain cooperatives.
 - (g) Determination of prevailing party.
 - (h) Examples.

§ 301.7430-6 Effective date.

§ 301.7430-2 Requirements and procedures for recovery of reasonable administrative costs.

(a) *Introduction.* Section 7430(a)(1) provides for the recovery, under certain circumstances, of reasonable administrative costs incurred in connection with an administrative proceeding before the Internal Revenue Service. Paragraph (b) of this section lists the requirements that a taxpayer must meet to be entitled to an award of reasonable administrative costs.

(b) *Requirements for recovery—(1) Determination by the Internal Revenue Service.* The Internal Revenue Service will grant a taxpayer's request for recovery of reasonable administrative costs incurred in connection with an administrative proceeding under section 7430 and this section only if—

(i) *Jurisdiction.* The underlying substantive issues or the issue of reasonable administrative costs are not, and have never been, before any court of the United States (including the Tax Court or United States Court of Federal Claims) with jurisdiction over those issues;

(ii) *Administrative proceeding.* The costs were incurred in connection with an administrative proceeding as defined in § 301.7430-3(a);

(iii) *Administrative proceeding date.* The costs were incurred on or after the administrative proceeding date as defined in § 301.7430-3(c);

(iv) *Reasonable administrative costs.* The costs were reasonable administrative costs as defined in § 301.7430-4;

(v) *Prevailing party.* The taxpayer is a prevailing party as defined in § 301.7430-5;

(vi) *Not unreasonably protracted.* The administrative proceeding was not unreasonably protracted by the taxpayer as discussed in paragraph (d) of this section; and

(vii) *Procedural requirements.* The taxpayer follows the procedures set forth in paragraph (c) of this section.

(2) *Determination by court.* Although the Internal Revenue Service will not grant a request for reasonable administrative costs where the requirements of paragraph (b)(1)(i) of this section are not met, a taxpayer may file a claim for reasonable administrative costs with the court with jurisdiction over the judicial proceeding. The court may award the taxpayer reasonable administrative costs under section 7430(a). Under section 7430(c)(4)(B)(ii), where the final determination with respect to the tax, interest, or penalty at issue is made by

a court, the court determines whether the taxpayer qualifies as a prevailing party. Thus, where the requirements of paragraph (b)(1)(i) of this section are not met, the taxpayer's only possibility of obtaining an award of reasonable administrative costs is to obtain an award of such costs from the court. In the event the court awards reasonable administrative costs, it may also award litigation costs for the reasonable costs of pursuing the claim for reasonable administrative costs, provided the requirements under section 7430 regarding an award of reasonable administrative costs are satisfied with respect to such costs. A claim filed with the court should be made in accordance with the rules of the court.

(c) *Procedure for recovering reasonable administrative costs*—(1) *In general.* The Internal Revenue Service will not award administrative costs under section 7430 unless the taxpayer files a written request to recover reasonable administrative costs in accordance with the provisions of this section.

(2) *Where request must be filed.* A request required by paragraph (c)(1) of this section must be filed with the Internal Revenue Service personnel who have jurisdiction over the tax matter underlying the claim for the costs. However, if those persons are unknown to the taxpayer making the request, the taxpayer may send the request to the District Director for the district that considered the underlying matter.

(3) *Contents of request.* The request must be in writing and must contain the following statements, affidavits, documentation, and information with regard to the taxpayer's administrative proceeding:

(i) *Statements.* (A) A statement that the underlying substantive issues or the issue of reasonable administrative costs are not, and have never been, before any court of the United States (including the Tax Court or United States Court of Federal Claims) with jurisdiction over those issues;

(B) A clear and concise statement of the reasons why the taxpayer alleges that the position of the Internal Revenue Service in the administrative proceeding was not substantially justified;

(C) A statement sufficient to demonstrate that the taxpayer has substantially prevailed as to the amount in controversy or with respect to the most significant issue or set of issues presented in the proceeding;

(D) A statement that the taxpayer has not unreasonably protracted the portion of the administrative proceeding for which the taxpayer is requesting costs; and

(E) A statement supported by a detailed affidavit executed by the taxpayer or the taxpayer's representative that sets forth the nature and amount of each specific item of reasonable administrative costs for which the taxpayer is seeking recovery.

(ii) *Affidavit or affidavits.* (A) An affidavit executed by the taxpayer stating that the taxpayer meets the net worth and size limitations of § 301.7430-5(f);

(B) An affidavit supporting the statement described in paragraph (c)(3)(i)(E) of this section; and

(C) If more than \$75 per hour, as adjusted by an increase in the cost of living as set forth in § 301.7430-4(b)(3), is claimed for the fees of a representative in connection with the administrative proceeding, then an affidavit that specialized skills and distinctive knowledge as described in that section were necessary in the representation of the taxpayer in the proceeding and that there is a limited availability of representatives possessing such skills and knowledge as described in that section, or an affidavit that another special factor is applicable.

(iii) *Documentation and information.* (A) A copy of the billing records of the representative for the requested fees; and

(B) An address at which the taxpayer wishes to receive notice of the determination of the Internal Revenue Service with regard to the request for reasonable administrative costs.

(4) *Form of Request.* No specific form is required for the request other than one which satisfies the requirements of paragraph (c)(3) of this section. Where practicable the required statements may be included in a single document. Similarly, where practicable, the required affidavits may be combined in a single affidavit to the extent they are to be executed by the same person.

(5) *Period for requesting costs from the Internal Revenue Service.* To recover reasonable administrative costs pursuant to section 7430 and this section, the taxpayer must file a request for costs no later than 90 days after the date the final decision of the Internal Revenue Service with respect to all tax, additions to tax and penalties at issue in the administrative proceeding is mailed, or otherwise furnished, to the taxpayer. The final decision of the Internal Revenue Service for purposes of this section is the document which resolves the tax liability of the taxpayer with regard to all tax, additions to tax and penalties at issue in the administrative proceeding (such as a Form 870 or closing agreement), or a notice of assessment for that liability (such as the

notice and demand under section 6303), whichever is earlier mailed, or otherwise furnished, to the taxpayer. For purposes of this section, if the 90th day falls on a Saturday, Sunday, or a legal holiday, the 90-day period shall end on the next succeeding day which is not a Saturday, Sunday, or a legal holiday. The term legal holiday means a legal holiday in the District of Columbia. If the request for costs is to be filed with the Internal Revenue Service at an office of the Internal Revenue Service located outside the District of Columbia but within an internal revenue district, the term legal holiday also means a Statewide legal holiday in the State where such office is located.

(6) *Notice.* The Internal Revenue Service is authorized, but not required, to notify the taxpayer of its decision to grant or deny (in whole or in part) an award for reasonable administrative costs under section 7430 and this section by certified mail or registered mail. If the Internal Revenue Service does not respond on the merits to a request by the taxpayer for an award of reasonable administrative costs filed under paragraph (c)(1) of this section within 6 months after such request is filed, the Internal Revenue Service's failure to respond may be considered by the taxpayer as a decision of the Internal Revenue Service denying an award for reasonable administrative costs.

(7) *Appeal to Tax Court.* A taxpayer may appeal a decision by the Internal Revenue Service denying (in whole or in part) a request for reasonable administrative costs under section 7430 and this section by filing a petition for reasonable administrative costs with the Tax Court. The petition must be in accordance with the Tax Court's Rules of Practice and Procedure and must be filed with the Tax Court after the Internal Revenue Service denies (in whole or in part) the taxpayer's request for reasonable administrative costs.

(d) *Unreasonable protraction of administrative proceeding.* An award of reasonable administrative costs will not be made where the taxpayer unreasonably protracted the administrative proceeding. However, a taxpayer that unreasonably protracted only a portion of the administrative proceeding, but not other portions of the administrative proceeding, may recover reasonable administrative costs for the portion(s) of the administrative proceeding that the taxpayer did not unreasonably protract, if the requirements of paragraph (b)(1) of this section are otherwise satisfied.

(e) *Examples.* The provisions of this section are illustrated by the following examples:

Example 1. Taxpayer A receives a notice of proposed deficiency (30-day letter). A requests and is granted Appeals office consideration. Appeals requests that A submit certain documents as substantiation for the tax matters at issue. Although A complies with this request, the information is misdirected and not considered by Appeals. Appeals then issues a notice of deficiency. A does not file a petition with the Tax Court. After receiving the notice of deficiency, A convinces Appeals that the notice of deficiency is incorrect and that A owes no tax. Appeals then closes the case showing a zero deficiency and mails A a notice to this effect. Assuming that the other requirements of this section are satisfied, A may recover reasonable administrative costs incurred after the date of the notice of deficiency (the administrative proceeding date). To recover these costs, A must file a request for costs with the Appeals office personnel who settled A's tax matter, or if that person is unknown to A, with the District Director of the district which considered the underlying matter, within 90 days after the date of mailing of the Office of Appeals' final decision that A owes no tax.

Example 2. Assume the same facts as in *Example 1*, except that after receipt of the notice of deficiency, A meets with an Appeals officer, but no agreement is reached on the tax matters at issue. A then files a petition with the Tax Court and prevails. Since the underlying tax issues have been determined by a court, the Internal Revenue Service will not grant a request for recovery of the reasonable administrative costs incurred by A. To recover reasonable administrative costs, A must file a claim with the Tax Court as prescribed under the Tax Court's Rules of Practice and Procedure.

§ 301.7430-3 Administrative proceeding and administrative proceeding date.

(a) *Administrative proceeding.* For purposes of section 7430, an administrative proceeding generally means any procedure or other action before the Internal Revenue Service that is commenced after November 10, 1988. However, an administrative proceeding does not include—

(1) Proceedings involving matters of general application, including hearings on regulations, comments on forms, or proceedings involving revenue rulings or revenue procedures;

(2) Proceedings involving requests for private letter rulings or similar determinations;

(3) Proceedings involving technical advice memoranda, except those submitted after the administrative proceeding date (as defined in paragraph (c) of this section); and

(4) Proceedings in connection with collection actions (as defined in paragraph (b) of this section), including

proceedings under sections 7432 or 7433.

(b) *Collection action.* A collection action generally includes any action taken by the Internal Revenue Service to collect a tax (or any interest, additional amount, addition to tax, or penalty, together with any costs in addition to the tax) or any action taken by a taxpayer in response to the Internal Revenue Service's act or failure to act in connection with the collection of a tax (including any interest, additional amount, addition to tax, or penalty, together with any costs in addition to the tax). For example, a collection action for purposes of section 7430 and this section includes any action taken by the Internal Revenue Service under Chapter 64 of Subtitle F to collect a tax. Collection actions also include those actions taken by a taxpayer to remedy the Internal Revenue Service's failure to release a lien under section 6325 and to remedy any unauthorized collection action as defined by section 7433. However, an action or procedure directly relating to a claim for refund filed with the Service Center's Collection Branch or District Director's Collection Division after payment of an assessed tax is not a collection action.

(c) *Administrative proceeding date.* (1) *General rule.* For purposes of section 7430 and the regulations thereunder, the term administrative proceeding date means the earlier of—

(i) The date of the receipt by the taxpayer of the notice of the decision of the Internal Revenue Service Office of Appeals; or

(ii) The date of the notice of deficiency.

(2) *Notice of the decision of the Internal Revenue Service Office of Appeals.* For purposes of section 7430 and the regulations thereunder, a notice of the decision of the Internal Revenue Service Office of Appeals is the final written document, mailed or delivered to the taxpayer, that is signed by an individual in the Office of Appeals who has been delegated the authority to settle the dispute on behalf of the Commissioner, and states or indicates that the notice is the final determination of the entire case. A notice of claim disallowance issued by the Office of Appeals is a notice of the decision of the Internal Revenue Service Office of Appeals. Solely for purposes of determining the administrative proceeding date, a notice of deficiency issued by the Office of Appeals is not a notice of the decision of the Internal Revenue Service Office of Appeals.

(3) *Notice of deficiency.* A notice of deficiency is a notice described in section 6212(a), including a notice

rescinded pursuant to section 6212(d). For purposes of determining reasonable administrative costs under section 7430 and the regulations thereunder, a notice of final partnership administrative adjustment described in section 6223(a)(2) will be treated as a notice of deficiency. A notice of final S corporation administrative adjustment issued pursuant to section 6223(a)(2) as made applicable to subchapter S items by section 6244 will also be treated as a notice of deficiency.

(d) *Examples.* The provisions of this section are illustrated by the following examples:

Example 1. Taxpayer A receives a notice of proposed deficiency (30-day letter). A files a request for and is granted an Appeals office conference. At the conference, an agreement is reached on the tax matters at issue. A cannot recover any costs because they were not incurred on or after the administrative proceeding date, which is the earlier of the date of receipt by the taxpayer of the notice of the decision of the Internal Revenue Service Office of Appeals, or the date of the notice of deficiency.

Example 2. Taxpayer B receives a notice of proposed deficiency (30-day letter). B pays the amount of the proposed deficiency and files a claim for refund. B's claim is disallowed and a notice of proposed disallowance is issued by the District Director. B does not request an Appeals office conference and the District Director issues a notice of claim disallowance. B then files suit in a United States District Court. B cannot recover reasonable administrative costs because, although the District Director issued a notice of claim disallowance, the Internal Revenue Service did not issue either a notice of decision of the Internal Revenue Service Office of Appeals or a notice of deficiency.

Example 3. Assume the same facts as in *Example 2*, except that after B files a claim for refund and receives the notice of proposed disallowance, B requests and is granted Appeals office consideration. No agreement is reached with Appeals and the Office of Appeals issues a notice of claim disallowance. B does not file suit in District Court but instead contacts the Appeals office to attempt to reverse the decision. B convinces the Appeals officer that the notice of claim disallowance is in error. The Appeals officer then abates the assessment. Because a notice of claim disallowance issued by Appeals is a notice of the decision of the Internal Revenue Service Office of Appeals, B may recover reasonable administrative costs incurred on or after the receipt of the notice of claim disallowance (the administrative proceeding date), but only if the other requirements of section 7430 and the regulations thereunder are satisfied. B cannot recover the costs incurred prior to receipt of the notice of claim disallowance because they were incurred before the administrative proceeding date.

Example 4. Taxpayer C receives a notice of proposed deficiency (30-day letter). C files a request for and is granted an Appeals office conference. At the Appeals conference no

agreement is reached on the tax matters at issue. The Office of Appeals then issues a notice of deficiency. Upon receiving the notice of deficiency C does not file a petition with the Tax Court. Instead, C pays the deficiency and files a claim for refund. The claim for refund is considered by the Internal Revenue Service and the District Director issues a notice of proposed disallowance. C requests and is granted Appeals office consideration. C convinces Appeals that C's claim is correct and Appeals allows C's claim. C may recover reasonable administrative costs incurred on or after the date of the notice of deficiency (the administrative proceeding date), but only if the other requirements of section 7430 and the regulations thereunder are satisfied.

Example 5. Taxpayer D receives a District Director's Collection Division (Collection) proposed assessment of trust fund taxes (Trust Fund Recovery Penalty) pursuant to section 6672. D requests and is granted Appeals office consideration. Upon consideration, Appeals upholds D's position. D cannot recover reasonable administrative costs because the costs were not incurred on or after the administrative proceeding date.

Example 6. Taxpayer E files an individual income tax return showing a balance due. No payment is made with the return and the Internal Revenue Service assesses the amount shown on the return. The Internal Revenue Service issues a notice and demand for tax pursuant to section 6303. E contacts the Collection Division (Collection) regarding E's outstanding liability. No agreement is reached with respect to the timing of E's payment, and Collection issues a notice of intent to levy pursuant to section 6331(d). Prior to the levy, E enters into an installment agreement with Collection. The costs that E incurred in connection with the notice and demand were not incurred in an administrative proceeding, but rather in a collection action. Accordingly, E may not recover those costs as reasonable administrative costs under section 7430 and the regulations thereunder.

Example 7. Taxpayer F receives a District Director's Collection Division (Collection) proposed assessment of trust fund taxes (Trust Fund Recovery Penalty) pursuant to section 6672. F requests and is granted Appeals office consideration. Appeals considers the issues and decides to uphold Collection's recommended assessment. Appeals notifies F of this decision in writing. Collection then assesses the tax. Pursuant to section 6672(b), within 30 days after the notice and demand is made, F pays the minimum amount required to commence a court proceeding, files a claim for refund, and furnishes the required bond. Collection then considers and disallows the claim. Appeals then reconsiders the claim and reverses its original position, thus upholding F's position. Appeals then abates the assessment. F may recover reasonable administrative costs incurred after the receipt of the original decision of Appeals (the administrative proceeding date) that Appeals was upholding Collection's recommended assessment, but only if the other requirements of section 7430 and the regulations thereunder are satisfied. F cannot

recover costs that are attributable to any procedure or other action before Collection prior to filing F's administrative claim for refund.

§ 301.7430-4 Reasonable administrative costs.

(a) *In general.* For purposes of section 7430 and the regulations thereunder, reasonable administrative costs are any costs described in paragraph (b) of this section that are incurred in connection with an administrative proceeding (as defined in § 301.7430-3(a)) and incurred on or after the administrative proceeding date (as defined in § 301.7430-3(c)).

(b) *Costs described—(1) In general.* The costs described in this paragraph are the reasonable and necessary amount of costs incurred by the taxpayer to present the taxpayer's position with respect to the merits of the tax controversy or the recovery of reasonable administrative costs. These costs include—

(i) Any administrative fees or similar charges imposed by the Internal Revenue Service;

(ii) Reasonable expenses of expert witnesses;

(iii) Reasonable costs of any study, analysis, engineering report, test or project that is necessary for, and incurred in preparation of, the taxpayer's case; and

(iv) Reasonable fees paid or incurred for the services of a representative (as defined in paragraph (b)(2) of this section) in connection with the administrative proceeding.

(2) Representative and specially qualified representative—(i)

Representative. A representative is a person compensated for services rendered in connection with the administrative proceeding, who is authorized to practice before the Internal Revenue Service or the Tax Court.

(ii) **Specially qualified representative.** For purposes of paragraphs (b)(3)(iii) and (c)(2)(ii) of this section, a specially qualified representative is a representative (as defined in paragraph (b)(2)(i) of this section) possessing a distinctive knowledge or a unique and specialized skill that is necessary to adequately represent the taxpayer in the proceeding. Examples of a unique and specialized skill or distinctive knowledge would be an identifiable practice specialty such as patent law or knowledge of a foreign law or language where such specialty or knowledge is necessary to adequately represent the taxpayer in the proceeding. For purposes of this paragraph, neither knowledge of tax law nor experience in

representing taxpayers before the Internal Revenue Service is considered distinctive knowledge or a unique and specialized skill. An extraordinary level of general representational knowledge and ability that is useful in all proceedings is not considered, in and of itself, distinctive knowledge or a unique and specialized skill. Specially qualified representatives also do not include those who have a distinctive knowledge of the underlying subject matter of the controversy in circumstances where such distinctive knowledge could reasonably be supplied through the use of an expert, or could readily be obtained through literature pertaining to the subject.

(3) **Limitation on fees for a representative—(i) In general.** Except as otherwise provided in this section, fees described in paragraph (b)(1)(iv) of this section that are recoverable under section 7430 and the regulations thereunder as reasonable administrative costs may not exceed \$75 per hour increased by a cost of living adjustment (and if appropriate, a special factor adjustment).

(ii) **Cost of living adjustment—(A) In general.** The Internal Revenue Service will make a cost of living adjustment to the \$75 per hour limit by using the Consumer Price Index of All-Urban Consumers (CPI-U) published by the Department of Labor, Bureau of Labor Statistics and referenced in Internal Revenue Code section 1(f)(5). If the CPI-U is no longer published, a comparable index will be used, and any reference in this section to the CPI-U will be considered to refer to such comparable index.

(B) **Percentage adjustment.** For purposes of paragraph (b)(3)(ii)(A) of this section, the base year for determining the cost of living adjustment is the calendar year 1986. The cost of living adjustment for fees incurred in any calendar year subsequent to 1986 is the percentage (if any) by which the yearly average CPI-U for the calendar year immediately prior to the year in which the fees are incurred exceeds the January CPI-U for the calendar year 1986.

(iii) **Special factor adjustment—(A) In general.** If the presence of a special factor is demonstrated by the taxpayer, the amount reimbursable is the amount of reasonable fees paid or incurred by the taxpayer in connection with the proceeding for the services of a representative as defined in paragraph (b)(2)(i) of this section.

(B) **Special factor.** A special factor is a factor, other than an increase in the cost of living, which justifies an increase in the \$75 per hour limitation

of section 7430(c)(1)(B)(iii). The novelty and difficulty of the issues, the undesirability of the case, the work and the ability of counsel, the results obtained, and customary fees and awards in other cases, are factors applicable to a broad spectrum of litigation and do not constitute special factors for the purpose of increasing the \$75 per hour limitation. The limited availability of a specially qualified representative for the proceeding does constitute a special factor justifying an increase in the \$75 per hour limitation.

(C) *Limited availability.* Unless disputed by the Internal Revenue Service, limited availability of a specially qualified representative is established by demonstrating that a specially qualified representative for the proceeding is not available at the \$75 per hour rate (as adjusted for an increase in the cost of living). Initially, this showing may be made by submission of an affidavit signed by the taxpayer or by the taxpayer's counsel, that in a case similar to the taxpayer's, a specially qualified representative that practices within a reasonable distance from the taxpayer's principal residence or principal office would normally charge a client similar to the taxpayer at a rate in excess of this amount. If the Internal Revenue Service challenges this initial showing, the taxpayer may submit additional evidence to establish the limited availability of a specially qualified representative at the rate specified above.

(D) *Example.* The provisions of this section are illustrated by the following example:

Example. Taxpayer A is represented by B, a CPA and attorney with an LL.M. Degree in Taxation with Highest Honors and who regularly handles cases dealing with TEFRA partnership issues. B represents A in an administrative proceeding involving TEFRA partnership issues and subject to the provisions of this section. Assuming the taxpayer qualifies for an award of reasonable administrative costs by meeting the requirements of section 7430, the amount of the award attributable to the fees of B may not exceed the \$75 per hour limitation (as adjusted for the cost of living), absent a special factor. Under these facts alone, B is not a specially qualified representative since even extraordinary knowledge of the tax laws does not constitute distinctive knowledge or a unique and specialized skill constituting a special factor.

(c) *Certain costs excluded—*(1) *Costs not incurred in an administrative proceeding.* Costs that are not reasonable administrative costs for purposes of section 7430 include any costs incurred in connection with a proceeding that is not an administrative

proceeding within the meaning of § 301.7430-3.

(2) *Costs incurred in an administrative proceeding but not reasonable—*(i) *In general.* Costs incurred in an administrative proceeding that are incurred on or after the administrative proceeding date, and that are otherwise described in paragraph (b) of this section, are not recoverable unless they are reasonable in both nature and amount. For example, costs normally included in the hourly rate of the representative by the custom and usage of the representative's profession, when billed separately, are not recoverable separate and apart from the representative's hourly rate. Such costs typically include costs such as secretarial and overhead expenses. In contrast, costs which are normally billed separately may be reasonable administrative costs that may be recoverable in addition to the representative's hourly rate. Therefore, necessary costs incurred for travel; expedited mail delivery; messenger service; expenses while on travel; long distance telephone calls; and necessary copying fees imposed by the Internal Revenue Service, any court, bank or other third party, when normally billed separately from the representative's hourly rate, may be reasonable administrative costs.

(ii) *Special Rule for Expert Witness' Fees on Issue of Prevailing Market Rates.* Under paragraph (b)(3)(iii)(C) of this section, the taxpayer may initially establish a limited availability of specially qualified representatives for the proceeding by submission of an affidavit signed by the taxpayer or by the taxpayer's representative. The Internal Revenue Service may endeavor to rebut the affidavit submitted on this issue by demonstrating either that a specially qualified representative was not necessary to represent the taxpayer in the proceeding, that the taxpayer's representative is not a specially qualified representative or that the prevailing rate for specially qualified representatives does not exceed \$75 per hour (as adjusted for an increase in the cost of living). Unless the Internal Revenue Service endeavors to demonstrate that the prevailing rate for specially qualified representatives does not exceed \$75 per hour (as adjusted for an increase in the cost of living), fees for expert witnesses used to establish prevailing market rates are not included in the term reasonable administrative costs.

(3) *Litigation costs.* Litigation costs are not reasonable administrative costs because they are not incurred in

connection with an administrative proceeding. Litigation costs include—

- (i) Costs incurred in connection with the preparation and filing of a petition with the United States Tax Court or in connection with the commencement of any other court proceeding; and
- (ii) Costs incurred after the filing of a petition with the United States Tax Court or after the commencement of any other court proceeding.

(4) *Examples.* The provisions of this section are illustrated by the following examples:

Example 1. Taxpayer A receives a notice of proposed deficiency (30-day letter). A files a request for and is granted an Appeals office conference. At the conference no agreement is reached on the tax matters at issue. The Internal Revenue Service then issues a notice of deficiency. Upon receiving the notice of deficiency, A discontinues A's administrative efforts and files a petition with the Tax Court. A's costs incurred in connection with the preparation and filing of a petition with the Tax Court are litigation costs and not reasonable administrative costs. Furthermore, A's costs incurred before the administrative proceeding date (date of the notice of deficiency as set forth in § 301.7430-3(c)(3)), are not reasonable administrative costs.

Example 2. Assume the same facts as in *Example 1* except that after A receives the notice of deficiency, A recontacts Appeals. Again, A's costs incurred before the administrative proceeding date, the date of the notice of deficiency as set forth in § 301.7430-3(c)(3), are not reasonable administrative costs. A's costs incurred in recontacting and working with Appeals after the issuance of the notice of deficiency, and up to and including the time of filing of the petition, are reasonable administrative costs. A's costs incurred in connection with the filing of a petition with the Tax Court are not reasonable administrative costs because those costs are litigation costs. Similarly, A's costs incurred after the filing of the petition are not reasonable administrative costs, as those are litigation costs.

§ 301.7430-5 Prevailing party.

(a) *In general.* For purposes of an award of reasonable administrative costs under section 7430, a taxpayer is a prevailing party only if the taxpayer—

- (1) Establishes that the position of the Internal Revenue Service was not substantially justified;
- (2) Substantially prevails as to the amount in controversy or with respect to the most significant issue or set of issues presented; and
- (3) Satisfies the net worth and size limitations referenced in paragraph (f) of this section.

(b) *Position of the Internal Revenue Service.* The position of the Internal Revenue Service in an administrative proceeding is the position taken by the Internal Revenue Service as of the administrative proceeding date (as

defined in § 301.7430-3(c)) or any date thereafter.

(c) *Substantially justified*—(1) *In general.* The position of the Internal Revenue Service is substantially justified if it has a reasonable basis in both fact and law. A significant factor in determining whether the position of the Internal Revenue Service is substantially justified as of a given date is whether, on or before that date, the taxpayer has presented all relevant information under the taxpayer's control and relevant legal arguments supporting the taxpayer's position to the appropriate Internal Revenue Service personnel. The appropriate Internal Revenue Service personnel are personnel responsible for reviewing the information or arguments, or personnel who would transfer the information or arguments in the normal course of procedure and administration to the personnel who are responsible.

(2) *Exception.* If the position of the Internal Revenue Service was substantially justified with respect to some issues in the proceeding and not substantially justified with respect to the remaining issues, any award of reasonable administrative costs to the taxpayer may be limited to only reasonable administrative costs attributable to those issues with respect to which the position of the Internal Revenue Service was not substantially justified. If the position of the Internal Revenue Service was substantially justified for only a portion of the period of the proceeding and not substantially justified for the remaining portion of the proceeding, any award of reasonable administrative costs to the taxpayer may be limited to only reasonable administrative costs attributable to that portion during which the position of the Internal Revenue Service was not substantially justified. Where an award of reasonable administrative costs is limited to that portion of the administrative proceeding during which the position of the Internal Revenue Service was not substantially justified, whether the position of the Internal Revenue Service was substantially justified is determined as of the date any cost is incurred.

(d) *Amount in controversy.* The amount in controversy shall include the amount in issue as of the administrative proceeding date as increased by any amounts subsequently placed in issue by any party. The amount in controversy is determined without increasing or reducing the amount in controversy for amounts of loss, deduction, or credit carried over from years not in issue.

(e) *Most significant issue or set of issues presented.* Where the taxpayer has not substantially prevailed with respect to the amount in controversy the taxpayer may nonetheless be a prevailing party if the taxpayer substantially prevails with respect to the most significant issue or set of issues presented. The issues presented include those raised as of the administrative proceeding date and those raised subsequently. Only in a multiple issue proceeding can a most significant issue or set of issues presented exist. However, not all multiple issue proceedings contain a most significant issue or set of issues presented. An issue or set of issues constitutes the most significant issue or set of issues presented if, despite involving a lesser dollar amount in the proceeding than the other issue or issues, it objectively represents the most significant issue or set of issues for the taxpayer or the Internal Revenue Service. This may occur because of the effect of the issue or set of issues on other transactions or other taxable years of the taxpayer or related parties.

(f) *Net worth and size limitations*—(1) *Individuals and estates.* An individual taxpayer or an estate meets the net worth and size limitations of this paragraph if, on the administrative proceeding date, the taxpayer's net worth does not exceed two million dollars. For this purpose, individuals filing a joint return shall be treated as 1 taxpayer, except in the case of a spouse relieved of liability under section 6013(e).

(2) *Others.* A taxpayer that is an owner of an unincorporated business, or any partnership, corporation, association, unit of local government, or organization (other than an organization described in paragraph (f)(3) of this section) meets the net worth and size limitations of this paragraph if, as of the administrative proceeding date—

(i) The taxpayer's net worth does not exceed seven million dollars; and

(ii) The taxpayer does not have more than 500 employees.

(3) *Special rule for charitable organizations and certain cooperatives.* An organization described in Internal Revenue Code section 501(c)(3) exempt from taxation under Internal Revenue Code section 501(a), or a cooperative association as defined in section 15(a) of the Agricultural Marketing Act, 12 U.S.C. 1141(j)(a) (as in effect on October 22, 1986), meets the net worth and size limitations of this paragraph if, as of the administrative proceeding date, the organization or cooperative association does not have more than 500 employees.

(g) *Determination of prevailing party.* If the final decision with respect to the tax, interest, or penalty is made at the administrative level, the determination of whether a taxpayer is a prevailing party shall be made by agreement of the parties, or absent such agreement, by the Internal Revenue Service. See § 301.7430-2(c)(7) regarding the right to appeal the decision of the Internal Revenue Service denying (in whole or in part) a request for reasonable administrative costs to the Tax Court.

(h) *Examples.* The provisions of this section are illustrated by the following examples:

Example 1. The Internal Revenue Service, in the conduct of a correspondence examination of taxpayer A's individual income tax return, requests substantiation from A of claimed medical expenses. A does not respond to the request and the Service Center issues a notice of deficiency. After receiving the notice of deficiency, A presents sufficient information and arguments to convince a revenue agent that the notice of deficiency is incorrect and that A owes no tax. The revenue agent then closes the case showing no deficiency. Although A incurred costs after the issuance of the notice of deficiency, A is unable to recover these costs because, as of the date these costs were incurred, A had not presented relevant information under A's control and relevant legal arguments supporting A's position to the appropriate Internal Revenue Service personnel. Accordingly, the position of the Internal Revenue Service was substantially justified at the time the costs were incurred.

Example 2. In the purchase of an ongoing business, taxpayer B obtains from the previous owner of the business a covenant not to compete for a period of five years. On audit of B's individual income tax return for the year in which the business is acquired, the Internal Revenue Service challenges the basis assigned to the covenant not to compete and a deduction taken as a business expense for a seminar attended by B. Both parties agree that the covenant not to compete is amortizable over a period of five years. However, the Internal Revenue Service asserts that the proper basis of the covenant is \$2X while the taxpayer asserts the basis is \$4X. Thus, under the Internal Revenue Service's position, B is entitled to a deduction of two-fifths \$X in the year under audit and for each of the subsequent four years. B's position, however, would result in a deduction of four-fifths \$X for the year under audit and each of the subsequent four years. The deduction for the seminar attended by B was reported on the return in question in the amount of \$X. The Internal Revenue Service's position is that the deduction for the seminar should be disallowed entirely. In the notice of deficiency, the Internal Revenue Service determines adjustments of two-fifths \$X (the difference between the Internal Revenue Service's position of two-fifths \$X and the reported four-fifths \$X) regarding the basis of the covenant not to compete, and \$X resulting from the disallowance of the

seminar expense. Thus, of the two adjustments determined for the year under audit, that attributable to the disallowance of the seminar is larger than that attributable to the covenant not to compete. However, due to the impact on the next succeeding four years, the covenant not to compete adjustment is objectively the most significant issue to both B and the Internal Revenue Service.

Example 3. The Collection Branch of a Service Center of the Internal Revenue Service determines in the matching process of various Forms 1099 and W-2 that taxpayer C has not filed an individual income tax return. The Internal Revenue Service sends notices to C requesting that C file an income tax return. C does not file a return, so the Service Center's Collection Branch prepares a substitute for return pursuant to section 6020(b). The calculation is sent to C requesting that C either sign the return pursuant to section 6020(a) or file a tax return prepared by C. C does not respond to the Internal Revenue Service's request and the Service Center's Collection Branch issues a notice of deficiency based on information in its possession. C does not file a petition with the Tax Court and does not pay the asserted deficiency. The Internal Revenue Service then assesses the tax shown on the notice of deficiency and issues a notice and demand for tax pursuant to section 6303. After receiving notice and demand, C contacts the Collection Branch and convinces Collection to stay the collection process because C does not owe any taxes. The Collection Branch recommends that the Examination Division examine the tax liability and make an adjustment to income. The Examination Division then redetermines the tax and abates the assessment due to information and arguments presented by C at that time. The costs C incurred before the Collection Branch are incurred in connection with an action taken by the Internal Revenue Service to collect a tax. Therefore, these costs are incurred with respect to a collection action and not an administrative proceeding. Accordingly, they are not recoverable as reasonable administrative costs. Costs incurred before the Examination Division are reasonable administrative costs; however, C may not recover any reasonable administrative costs with respect to the proceeding before the Examination Division because, as of the date the costs were incurred, C had not previously presented all relevant information under C's control and all relevant legal arguments supporting C's position to the Collection Branch or Examination Division personnel (the appropriate Internal Revenue Service personnel under § 301.7430-5(c)), and thus, the position of the Internal Revenue Service was substantially justified based upon the information it had.

§ 301.7430-6 Effective date.

Sections 301.7430-0, and 301.7430-2 through 301.7430-6, other than § 301.7430-2(c)(5), apply to claims for reasonable administrative costs filed with the Internal Revenue Service after December 23, 1992, with respect to costs incurred in administrative proceedings

commenced after November 10, 1988. Section 301.7430-2(c)(5) is effective March 23, 1993.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 3. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

§ 602.101 [Amended]

Par. 4. Section 602.101(c) is amended by adding the entry "301.7430-2(c) . . . 1545-1356" in numerical order in the table.

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved: May 9, 1994.

Leslie Samuels,

Assistant Secretary of the Treasury.

[FR Doc. 94-12828 Filed 6-6-94; 8:45 am]

BILLING CODE 4830-01-M

Bureau of Alcohol, Tobacco and Firearms

27 CFR Part 70

[T.D. ATF-358]

RIN 1512-AB27

Clarification of Periods of Interest With Respect to Certain Overpayments (T92-122)

AGENCY: Bureau of Alcohol, Tobacco and Firearms (ATF), Treasury.

ACTION: Treasury decision, final rule.

SUMMARY: This Treasury decision amends 27 CFR 70.92, in Part 70, Procedure and Administration. The amendments clarify the period during which interest is allowed on taxpayer overpayments which are credited against other liabilities of the same taxpayer for interest and certain additions to the tax. The amendments are necessary as a result of changes to the law made by the Tax Equity and Fiscal Responsibility Act of 1982 and the Deficit Reduction Act of 1984. The regulations affect all taxpayers who have overpayments credited against underpayments.

EFFECTIVE DATE: These regulations are effective on June 7, 1994.

FOR FURTHER INFORMATION CONTACT:

Jackie White of the Tax Compliance Branch, (202) 927-8220, Bureau of Alcohol, Tobacco and Firearms, P.O. Box 50221, Washington, DC 20091-0221 ((202) 927-8220).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the regulations on Procedure and Administration (27 CFR part 70) under § 6611 of the Internal Revenue Code of 1986 (IRC) to clarify the period during which interest is allowed on overpayments that are credited against a taxpayer's liability for interest and certain additions to the tax. The amendments will conform the regulations to § 344 of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) (Pub. L. 97-248, 96 Stat. 635), and § 158 of the Deficit Reduction Act of 1984 (DEFRA) (Pub. L. 98-369, 98 Stat. 696).

The Internal Revenue Service (IRS) applies § 6611 to the taxes it administers and enforces. The IRS published a notice of proposed rulemaking in the *Federal Register* on August 25, 1992 (57 FR 38457), and Treasury Decision 8524 (59 FR 10075) was published in the *Federal Register* on March 3, 1994, adopting final rules implementing the TEFRA and DEFRA amendments. ATF believes these regulations are equally applicable to its tax collection activities and is adopting such regulations.

Interest on Overpayments That Are Credited Against Interest on Underpayments

Section 6611(a) of the IRC provides that interest shall be allowed and paid on any overpayment in respect of any internal revenue tax at the overpayment rate established under § 6621.

Under § 6402(a), the Secretary may credit any overpayment (including any interest allowed thereon) against any liability imposed on the taxpayer under the IRC. Under § 6611(b)(1), interest is allowed on an overpayment that is so credited from the date of the overpayment to the due date of the taxpayer's liability against which the overpayment is credited. For purposes of this interest computation, a definition of the term "due date" is provided in § 70.92(d) of the regulations.

Generally, § 6601(f) provides that once an overpayment is credited to satisfy a taxpayer's liability, interest no longer accrues on that liability. Section 344 of TEFRA added § 6622 of the IRC, which requires interest imposed by the IRC to be compounded daily. The effect of § 6601(f) on the compounding requirement of § 6622 is that once an overpayment is credited to satisfy the taxpayer's liability for interest, that credit cuts off any further compounding of the interest (i.e., interest no longer accrues on the taxpayer's interest

liability against which the credit has been made).

Similarly, it is appropriate that no interest liability to the taxpayer accrues on the overpayment once the overpayment is credited to satisfy the taxpayer's liability for interest. Thus, the regulations amend § 70.92(d)(2)(iii) to clarify that interest ceases to accrue on any portion of an overpayment that is credited against the taxpayer's liability for interest.

Interest on Overpayments That Are Credited Against Certain Additions to the Tax

Prior to DEFRA, interest only accrued on additions to the tax from the date of notice and demand, and then only if not paid within 10 days from the date of notice and demand. In § 158 of DEFRA, Congress added § 6601(e)(2)(B) to the IRC, requiring taxpayers to pay interest on certain additions to tax from the due date of the relevant return (including any extensions) until the addition to the tax is paid. The number of additions to the tax that bear interest from the due date of the return was increased by Congress in 1988 and again in 1989. This regulation amends § 70.92(d)(2)(iv) to clarify that interest ceases to accrue on any portion of an overpayment that is credited against certain additions to the tax for any period after the due date of the return (including extensions) to which the addition to the tax relates.

Prior Regulations Obsolete

When ATF assumed responsibility for the collection and enforcement of taxes imposed under Subtitle E of the IRC, it patterned many of its procedural regulations upon those already promulgated by the IRS. See, e.g., T.D. ATF-301, 55 Fed. Reg. 47608 (November 14, 1990); T.D. ATF-251, 52 Fed. Reg. 19314 (May 22, 1987). However, since enactment of § 6622 of the IRC in TEFRA and § 6601(e)(2)(B) in DEFRA, the prior regulations regarding interest and certain additions to tax have been obsolete. Accordingly, ATF has been computing interest consistent with the statutory changes and these regulatory amendments acknowledge existing agency practice.

Regulatory Flexibility Act

The provisions of the Regulatory Flexibility Act relating to a final regulatory flexibility analysis (5 U.S.C. 604) are not applicable to this final rule because the agency was not required to publish a general notice of proposed rulemaking under 5 U.S.C. 553 or any other law. A copy of this final rule has been submitted to the Administrator of the Small Business Administration for

comment on the impact of such regulation on small business, pursuant to 26 U.S.C. 7805(f).

Executive Order 12866

It has been determined that this rule is not a significant regulatory action because (1) it will not have an annual effect on the economy of \$100 million or more or adversely affect in a material way the economy, a sector of the economy productivity, competition, jobs, the environment, public health or safety, or State, local or tribal governments or communities; (2) create a serious inconsistency or otherwise interfere with an action taken or planned by another agency; (3) materially alter the budgetary impact of entitlements, grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) raise novel legal or policy issues arising out of legal mandates, the Presidents priorities, or the principles set forth in Executive Order 12866.

Administrative Procedures Act

Because this final rule merely adopts existing IRS procedural regulations regarding overpayment interest, it is found to be unnecessary to issue this Treasury decision for notice and public procedure pursuant to 5 U.S.C. 553(b) or subject to the effective date limitation in 5 U.S.C. 553(d).

Paperwork Reduction Act

The provisions of the Paperwork Reduction Act of 1980, Pub. L. No. 96-511, 44 U.S.C. Chapter 35, and its implementing regulations, 5 CFR Part 1320, do not apply to this final rule because it does not impose any new recordkeeping or reporting requirements.

Drafting Information

The principal author of this document is Jackie White of the Tax Compliance Branch, Bureau of Alcohol, Tobacco and Firearms.

List of Subjects in 27 CFR Part 70

Administrative practice and procedure, Alcohol and alcoholic beverages, Authority delegations, Bankruptcy, Claims, Excise taxes, Firearms and ammunition, Government employees, Law enforcement, Law enforcement officers, Penalties, Reporting and recordkeeping requirements, Seizures and forfeitures, Surety bonds, Tobacco.

Authority and Issuance

Title 27 CFR is amended as follows:

PART 70—[AMENDED]

Paragraph 1. The authority citation for part 70 continues to read as follows:

Authority: 5 U.S.C. 301 and 552; 26 U.S.C. 4181, 4182, 5146, 5203, 5207, 5275, 5367, 5415, 5504, 5555, 5684(a), 5741, 5761(b), 6020, 6021, 6064, 6102, 6155, 6159, 6201, 6203, 6204, 6301, 6303, 6311, 6313, 6314, 6321, 6323, 6325, 6326, 6331-6343, 6401-6404, 6407, 6416, 6423, 6501-6503, 6511, 6513, 6514, 6532, 6601, 6602, 6611, 6621, 6622, 6651, 6653, 6656, 6657, 6658, 6665, 6671, 6672, 6701, 6723, 6801, 6862, 6863, 6901, 7011, 7101, 7102, 7121, 7122, 7207, 7209, 7214, 7304, 7401, 7403, 7406, 7423, 7424, 7425, 7426, 7429, 7430, 7432, 7502, 7503, 7505, 7506, 7513, 7601-7606, 7608-7610, 7622, 7623, 7653, 7805.

Para. 2. Section 70.92 is amended by revising paragraphs (d)(2)(iii) and (d)(2)(iv) to read as follows:

§ 70.92 Interest on overpayments.

* * * * *

(d) * * *

(2) * * *

(iii) *Interest.* In the case of a credit against interest that accrues for any period ending prior to January 1, 1983, the due date is the earlier of the date of assessment of such interest or December 31, 1982. In the case of a credit against interest that accrues from any period beginning on or after December 31, 1982, such interest is due as it economically accrues on a daily basis, rather than when it is assessed.

(iv) *Additional amount, addition to the tax, or assessable penalty.* In the case of a credit against an additional amount, addition to the tax, or assessable penalty, the due date is the earlier of the date of assessment or the date from which such amount would bear interest if not satisfied by payment or credit.

* * * * *

Signed: May 11, 1994.

Daniel R. Black,
Acting Director.

Approved: May 19, 1994.

John P. Simpson,
Deputy Assistant Secretary (Regulatory, Tariff and Trade Enforcement).

[FR Doc. 94-13742 Filed 6-6-94; 8:45 am]

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