

compliance with the Department of Defense National Industrial Security Program Operating Manual (DoD NISPOM) and pursuant to an approved transportation plan.

Dated: November 3, 2009.

Ellen O. Tauscher,

Under Secretary, Arms Control and International Security, Department of State.
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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 301

[REG-111833-99]

RIN 1545-AX46

Regulations Under I.R.C. Section 7430 Relating to Awards of Administrative Costs and Attorneys Fees

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to awards of administrative costs and attorneys fees under section 7430 to conform to the amendments made in the Taxpayer Relief Act of 1997 and the IRS Restructuring and Reform Act of 1998. The regulations affect taxpayers seeking attorneys fees and costs. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by February 8, 2010. Outlines of topics to be discussed at the public hearing scheduled for 10 a.m. on March 10, 2010 must be received by February 10, 2010.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-111833-99), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-111833-99), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS REG-111833-99). The public hearing will be held in the Internal Revenue Building, Room 2615, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT:

Concerning the hearing, submission of written comments, and to be placed on the building access list to attend the hearing, contact Regina Johnson, (202) 622-7180; concerning the proposed regulations, contact Ronald J. Goldstein (202) 622-4910 (not toll-free numbers).

Background and Explanation of Provisions

The proposed amendments to the Treasury Regulations incorporate the 1997 and 1998 amendments to section 7430 of the Internal Revenue Code relating to awards of attorneys fees. These amendments were enacted as part of the Taxpayer Relief Act of 1997, Public Law 105-34, 111 Stat. 788, and the IRS Restructuring and Reform Act of 1998, Public Law 105-206, 112 Stat. 685.

The Taxpayer Relief Act of 1997 (TRA) contained several amendments to section 7430 that are addressed in the proposed amendments to the regulations. First, the TRA provided that a taxpayer has ninety days after the date the IRS mails to the taxpayer a final decision determining tax, interest or penalty, to file an application with the IRS to recover administrative costs. Second, a taxpayer has ninety days after the date the IRS mails to the taxpayer, by certified or registered mail, a final adverse decision regarding an award of administrative costs, to file a petition with the Tax Court. Third, the TRA clarified the application of the net worth requirements by providing that individuals filing joint returns should be treated as separate taxpayers for purposes of determining net worth. The TRA added trusts to the list of taxpayers subject to the net worth requirements and also specified the date on which the net worth determination should be made.

The TRA also added section 7436 to the Code, which gives the Tax Court jurisdiction in certain employment tax cases. Under section 7436, if the IRS determines in connection with an audit that (1) one or more individuals performing services for the taxpayer are employees of the taxpayer or (2) the taxpayer is not entitled to relief from employment taxes under section 530 of the Revenue Act of 1978 with respect to the individual(s), and the IRS sends a Notice of Determination of Worker Classification (NDWC) to the taxpayer by certified or registered mail, the taxpayer may petition the Tax Court to determine (1) whether the IRS's determination, as set forth in the NDWC, is correct and (2) the proper amount of employment tax under the determination. Various restrictions on

assessment and collection in section 6213 apply to a section 7436 proceeding in the same manner as if the NDWC were a notice of deficiency. Section 7436(d)(2) provides that section 7430 applies to proceedings brought under section 7436.

The proposed amendments reflect the changes outlined in this preamble. Additional clarifying changes address the calculation of net worth. First, the regulation specifies that net worth will be calculated using the fair market value of assets to provide a more accurate assessment of a taxpayer's actual and current net worth as of the administrative proceeding date. Second, the regulation specifies which net worth and size limitations apply when a taxpayer is an owner of an unincorporated business. Third, the regulation has been amended to clarify the net worth requirement in cases involving partnerships subject to the unified audit and litigation procedures of sections 6221 through 6234 of the Code (the TEFRA partnership procedures).

The IRS Restructuring and Reform Act of 1998 (RRA) also contained several amendments affecting section 7430. First, the RRA increased the hourly rate limitation from \$110 per hour to \$125 per hour. Second, two special factors were added that may be considered to increase an attorney's hourly rate: Difficulty of the issues presented and local availability of tax experts. Third, the RRA added a provision that requires a court to consider whether the IRS has lost cases with substantially similar issues in other circuit courts of appeal in deciding whether the IRS's position was substantially justified. Fourth, the RRA created an exception to the requirement that to recover attorneys fees, the taxpayer must have paid or incurred the fees. The exception provides that if an individual who is authorized to practice before the Tax Court or the IRS is representing the taxpayer on a *pro bono* basis, then the taxpayer may petition for an award of reasonable attorneys fees in excess of the amounts that the taxpayer paid or incurred, as long as the fee award is ultimately paid to the individual or the individual's employer. Fifth, the period for recovery of reasonable administrative costs was extended to include costs incurred after the date on which the first letter of proposed deficiency, commonly known as a 30-day letter, is mailed to the taxpayer. The regulations clarify, however, that a taxpayer may be eligible to recover reasonable administrative costs from the date of the 30-day letter only if at least one issue (other than recovery of

administrative costs) remains in dispute as of the date that the IRS takes a position in the administrative proceeding.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed rules and how it may be made easier to understand. All public comments will be made available for public inspection and copying.

A public hearing has been scheduled for 10 a.m. on March 10, 2010 in the Internal Revenue Building, Room 2615, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having a visitor's name placed on the building access list to attend the hearing, see the FOR FURTHER INFORMATION CONTACT caption.

An outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) must be submitted by any person that wishes to present oral comments at the hearing. Outlines must be received by February 10, 2010.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving requests to speak has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Ronald J. Goldstein, Office of Associate Chief Counsel (Procedure and Administration).

List of Subjects in 26 CFR Part 301

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

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 301 is proposed to be 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. Section 301.7430-0 is amended by:

- 1. Adding a new entry for § 301.7430-3(c)(4).
2. Adding new entries for § 301.7430-4(b)(3)(iii)(A) through (F) and (d).
3. Revising the entries for § 301.7430-5.
4. Revising the section heading for § 301.7430-6.
5. Adding new entries for §§ 301.7430-7 and 301.7430-8.

The additions and revisions read as follows:

§ 301.7430-0 Table of contents.

* * * * *

§ 301.7430-3 Administrative proceeding and administrative proceeding date.

* * * * *

(c) * * *

(4) First letter of proposed deficiency that allows the taxpayer an opportunity for administrative review in the Office of Appeals.

* * * * *

§ 301.7430-4 Reasonable administrative costs.

* * * * *

(b) * * *

(3) * * *

(iii) * * *

(A) In general.

(B) Special factor.

(C) Limited availability.

(D) Local availability of tax expertise.

(E) Difficulty of the issues.

(F) Example.

(c) * * *

(d) Pro bono services.

(1) In general.

(2) Requirements.

(3) Nominal fee.

(4) Payment when services provided for a nominal fee.

(5) Requirements.

(6) Hourly rate.

(7) Examples.

§ 301.7430-5 Prevailing party.

(a) In general.

(b) Position of the Internal Revenue Service.

(c) Examples.

(d) Substantially justified.

(1) In general.

(2) Position in courts of appeal.

(3) Examples.

(4) Included costs.

(5) Examples.

(6) Exception.

(7) Presumption.

(e) Amount in controversy.

(f) Most significant issue or set of issues presented.

(1) In general.

(2) Example.

(g) Net worth and size limitations.

(1) Individuals.

(2) Estates and trusts.

(3) Others.

(4) Special rule for charitable organizations and certain cooperatives.

(5) Special rule for TEFRA partnerships.

(h) Determination of prevailing party.

(i) Examples.

§ 301.7430-6 Effective/applicability dates.

§ 301.7430-7 Qualified offers.

(a) In general.

(b) Requirements for treatment as a prevailing party based upon having made a qualified offer.

(1) In general.

(2) Liability under the last qualified offer.

(3) Liability pursuant to the judgment.

(c) Qualified offer.

(1) In general.

(2) To the United States.

(3) Specifies the offered amount.

(4) Designated at the time it is made as a qualified offer.

(5) Remains open.

(6) Last qualified offer.

(7) Qualified offer period.

(8) Interest as a contested issue.

(d) [Reserved].

(e) Examples.

(f) Effective date.

§ 301.7430-8 Administrative costs incurred in damage actions for violations of section 362 or 524 of the Bankruptcy Code.

(a) In general.

- (b) Prevailing party.
- (c) Administrative proceeding.
- (d) Costs incurred after filing of bankruptcy petition.
- (e) Time for filing claim for administrative costs.
- (f) Effective date.

Par. 3. Section 301.7430-1 is amended by:

1. Revising paragraphs (b)(1)(ii)(A), (d)(1)(i), (d)(1)(ii) and (d)(2) introductory text.
2. Removing the language “district director” in paragraphs (f)(2)(i), (f)(3)(ii), (f)(3)(iii), (f)(4)(i) and (g) *Examples 6, 7 and 8* and adding the language “Internal Revenue Service office” in its place in all locations.
3. Removing the language “such” in the second sentence of paragraph (g) *Example 9* and adding the language “these” in its place.

The revisions read as follows:

§ 301.7430-1 Exhaustion of administrative remedies.

* * * * *

- (b) * * *
- (1) * * *
- (ii) * * *

(A) Requests an Appeals office conference in accordance with §§ 601.105 and 601.106 of this chapter or any successor published guidance; and

* * * * *

- (d) * * *
- (1) * * *

(i) The party follows all applicable Internal Revenue Service procedures for contesting the matter (including filing a written protest or claim, requesting an administrative appeal, and participating in an administrative hearing or conference); or

(ii) If there are no applicable Internal Revenue Service procedures, the party submits to the area director of the area 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 the requested relief; and the area director has denied the claim for relief in writing or failed to act on the claim within a reasonable period after the claim is received by the area director.

(2) For purposes of paragraph (d)(1)(ii) of this section, a *reasonable period* is—

* * * * *

Par. 4. Section 301.7430-2 is amended by:

1. Adding the language “from the Internal Revenue Service” at the end of the last sentence of paragraph (a).
2. Removing the language “such” in the fourth and fifth sentences of paragraph (b)(2) and adding the

language “these” in its place in both locations.

3. Removing the “;” at the end of paragraph (c)(3)(i)(B) and adding a “.” in its place.
4. Adding a new sentence at the end of paragraphs (c)(3)(i)(B), (c)(3)(i)(E) and (c)(7).
5. Revising paragraphs (c)(3)(ii)(C), (c)(5) and (e).
6. Adding new paragraph (c)(3)(iii)(C).
7. Removing the language “which” in the first sentence of paragraph (c)(4) and adding the language “that” in its place.
8. Removing the language “such” in the second sentence of paragraph (c)(6) and adding the language “the” in its place.

The additions and revisions read as follows:

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

* * * * *

- (c) * * *
- (3) * * *
- (i) * * *
- (B) * * *

For costs incurred after January 18, 1999, if the taxpayer alleges that the United States has lost in courts of appeal for other circuits on substantially similar issues, the taxpayer must provide the full name of the case, volume and pages of the reporter in which the opinion appears, the circuit in which the case was decided, and the year of the opinion;

* * * * *

(E) * * * This statement must identify whether the representation is on a *pro bono* basis as defined in § 301.7430-4(d) and, if so, to whom payment should be made. Specifically, the statement must direct whether payment should be made to the taxpayer’s representative or to the representative’s employer.

- (ii) * * *

(C) For costs incurred after January 18, 1999, if more than \$125 per hour as adjusted for increases in the cost of living pursuant to § 301.7430-4(b)(3) is claimed for the fees of a representative in connection with the administrative proceeding, an affidavit stating that a special factor described in § 301.7430-4(b)(3) is applicable, such as the difficulty of the issues presented in the case or the lack of local availability of tax expertise. If a special factor is claimed based on specialized skills and distinctive knowledge as described in § 301.7430-4(b)(2)(ii), the affidavit must state—

- (1) Why the specialized skills and distinctive knowledge were necessary in the representation;
- (2) That there is a limited availability of representatives possessing these

specialized skills and distinctive knowledge; and

(3) How the education and experience qualifies the representative as someone with the necessary specialized skills and distinctive knowledge.

- (iii) * * *

(C) In cases of *pro bono* representation, time records similar to billing records, detailing the time spent and work completed must be submitted for the requested fees.

* * * * *

(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 written request for costs within 90 days after the date the final adverse decision of the Internal Revenue Service with respect to all tax, additions to tax, interest, and penalties at issue in the administrative proceeding is mailed or otherwise furnished to the taxpayer. For purposes of this section, *interest* means the interest that is specifically at issue in the administrative proceeding independent of the taxpayer’s objections to the underlying tax imposed. The final decision of the Internal Revenue Service for purposes of this section is the document that resolves the tax liability of the taxpayer with regard to all tax, additions to tax, interest, 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 that is not a Saturday, Sunday, or a legal holiday as defined by section 7503.

* * * * *

(7) * * * If the notice of decision denying (in whole or in part) an award for reasonable administrative costs was mailed by the Internal Revenue Service via certified mail or registered mail, a taxpayer may obtain judicial review of that decision by filing a petition for review with the Tax Court prior to the 91st day after the mailing of the notice of decision.

* * * * *

- (e) * * *

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. Appeals determines that the information submitted is

insufficient. Appeals then issues a notice of deficiency. After receiving the notice of deficiency but before the 90-day period for filing a petition with the Tax Court has expired, A convinces Appeals that the information submitted during the review by Appeals is sufficient and, therefore, the notice of deficiency is incorrect and A owes no additional tax. Appeals then closes the case showing a zero deficiency and mails A a notice to this effect. Assuming that all of the other requirements of section 7430 are satisfied, A may recover reasonable administrative costs incurred after the date of the 30-day letter (the administrative proceeding date). To recover these costs, A must file a request for administrative costs with the Appeals office personnel who settled A's tax matter, or if that person is unknown to A, with the Area Director of the area that considered the underlying matter, within 90 days after the date of mailing of the Office of Appeals' final decision that A owes no additional tax.

Example 2. Taxpayer B files a request for an abatement of interest pursuant to section 6404 and the regulations thereunder. The Area Director issues a notice of proposed disallowance of the abatement request (akin to a 30-day letter). B requests and is granted Appeals office consideration. No agreement is reached with Appeals and the Office of Appeals issues a notice of disallowance of the abatement request. B does not file suit in the Tax Court, but instead contacts the Appeals office within 180 days after the mailing date of the notice of disallowance of the abatement request to attempt to reverse the decision. B convinces the Appeals office that the notice of disallowance is in error. The Appeals office agrees to abate the interest and mails the taxpayer a notification of this decision. The mailing date of the notification from Appeals of the decision to abate interest commences the 90-day period from which the taxpayer may request administrative costs. Assuming that all of the other requirements of section 7430 are satisfied, B may recover reasonable administrative costs incurred after the date of the notice of proposed disallowance of the abatement request (the administrative proceeding date). To recover these costs, B must file a request for costs with the Appeals office personnel who settled B's tax matter, or if that person is unknown to B, with the Area Director of the area that considered the underlying matter within 90 days after the date of mailing of the Office of Appeals' final decision that B is entitled to abatement of interest.

Example 3. Taxpayer C receives a notice of proposed adjustment and employment tax 30-day letter. C requests and is granted Appeals office consideration. Appeals requests that C submit certain documents to support C's position in the tax matters at issue. Appeals determines that the documents submitted are insufficient. Appeals then issues a notice of determination of worker classification. After receiving the notice of determination but before the 90-day period for filing a petition with the Tax Court has expired, C convinces Appeals that the documents submitted during the review by Appeals adequately support its position and,

therefore, C owes no additional employment tax. Appeals then closes the case showing a zero tax adjustment and mails C a no-change letter. Assuming that all of the other requirements of section 7430 are satisfied, C may recover reasonable administrative costs incurred after the date of the notice of proposed adjustment and 30-day letter (the administrative proceeding date). To recover these costs, C must file a request for administrative costs with the Appeals office personnel who settled C's tax matter, or if that person is unknown to C, with the Area Director of the area that considered the underlying matter, within 90 days after the date of mailing of the Office of Appeals' final decision that C owes no additional tax.

Par. 5. Section 301.7430-3 is amended by:

1. Revising paragraphs (b), (c)(1), (c)(3) and (d).

2. Adding paragraph (c)(4).

The addition and revisions read as follows:

§ 301.7430-3 Administrative proceeding and administrative proceeding dates.

* * * * *

(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). 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 collection due process hearings under sections 6320 and 6330 (unless the underlying tax liability is properly at issue), and those actions taken by a taxpayer to remedy the Internal Revenue Service's failure to release a lien under section 6325 or to remedy any unauthorized collection action as defined by section 7433, except those collection actions described by section 7433(e). An action or procedure directly relating to a claim for refund 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;

(ii) The date of the notice of deficiency; or

(iii) The date on which the first letter of proposed deficiency that allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals is sent.

(2) * * *

(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, the following will be treated as a notice of deficiency:

(i) A notice of final partnership administrative adjustment described in section 6223(a)(2).

(ii) A notice of determination of worker classification issued pursuant to section 7436.

(iii) A final notice of determination denying innocent spouse relief issued pursuant to section 6015.

(4) *First letter of proposed deficiency that allows the taxpayer an opportunity for administrative review in the Office of Appeals.* Generally, the first letter of proposed deficiency that allows the taxpayer an opportunity for administrative review in the Office of Appeals is the first letter issued to the taxpayer that describes the proposed adjustments and advises the taxpayer of the opportunity to contact the Office of Appeals. It also may be a claim disallowance or the first letter of determination that allows the taxpayer an opportunity for administrative review in the Office of Appeals.

(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 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, A does not file a petition with the Tax Court. Instead, A pays the deficiency and files a claim for refund. The claim for refund is considered by the Internal Revenue Service and the Area Director issues a notice of proposed claim disallowance. A requests and is granted Appeals office consideration. A convinces Appeals that A's claim is correct and Appeals allows A's claim. A may recover reasonable administrative costs incurred on or after the date of the notice of proposed deficiency (30-day letter), but only if the other requirements of section 7430 and the regulations thereunder are satisfied. A cannot recover costs incurred prior to the date of the 30-day letter because these costs were incurred before the administrative proceeding date.

Example 2. Taxpayer B 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 of levy pursuant to section 6330. B requests and is granted a Collection Due Process (CDP) hearing. In connection with the CDP hearing, B enters into an installment agreement as a collection alternative. The costs that B incurred in connection with the CDP hearing were not incurred in an administrative proceeding, but rather in a collection action. Accordingly, B may not recover those costs as reasonable administrative costs under section 7430 and the regulations thereunder.

Par. 6. Section 301.7430–4 is amended by:

1. Removing the language “such” in the second and fifth sentences of paragraph (b)(2)(ii) and adding the language “that” in its place in both locations.

2. Revising paragraphs (b)(3)(i), (b)(3)(iii)(B), and (c)(4) *Examples 1* and 2.

3. Removing the language “\$110” from the first and second sentences in paragraph (b)(3)(ii) and adding the language “\$125” in its place in both locations.

4. Revising the first sentence in paragraph (b)(3)(iii)(C).

5. Redesignating paragraph (b)(3)(iii)(D) as paragraph (b)(3)(iii)(F) and revising newly-designated paragraph (b)(3)(iii)(F).

6. Adding new paragraphs (b)(3)(iii)(D), (b)(3)(iii)(E) and (d).

7. Removing the language “Such” in the third sentence of paragraph (c)(2)(i) and adding the language “These” in its place.

8. Removing the language “\$110” from the second and third sentences in paragraph (c)(2)(ii) and adding the language “\$125” in its place in both locations.

9. Removing the language “which” in the fourth sentence of paragraph (c)(2)(i) and adding the language “that” in its place.

The additions and revisions read as follows:

§ 301.7430–4 Reasonable administrative costs.

* * * * *

(b) * * *

(3) *Limitation on fees for a representative*—(i) *In general.* Except as otherwise provided in this section, fees incurred after January 18, 1999, and 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 \$125 per hour increased by a cost of living adjustment

(and if appropriate, a special factor adjustment).

* * * * *

(iii) * * *

(B) *Special factor.* A *special factor* is a factor, other than an increase in the cost of living, that justifies an increase in the \$125 per hour limitation of section 7430(c)(1)(B)(iii). 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 \$125 per hour limitation. By contrast, the limited availability of a specially qualified representative for the proceeding, the difficulty of the issues, and the limited local availability of tax expertise are special factors justifying an increase in the \$125 per hour limitation.

(C) *Limited availability.* Limited availability of a specially qualified representative is established by demonstrating that a specially qualified representative for the proceeding is not available at the \$125 per hour rate (as adjusted for an increase in the cost of living). * * *

(D) *Limited local availability of tax expertise.* Limited local availability of tax expertise is established by demonstrating that a representative possessing tax expertise is not available in the taxpayer’s geographical area. Initially, this showing may be made by submission of an affidavit signed by the taxpayer, or by the taxpayer’s counsel, that no representative possessing tax expertise practices within a reasonable distance from the taxpayer’s principal residence or principal office. The hourly rate charged by representatives in the geographical area is not relevant in determining whether tax expertise is locally available. If the Internal Revenue Service challenges this initial showing, the taxpayer may submit additional evidence to establish the limited local availability of a representative possessing tax expertise.

(E) *Difficulty of the issues.* In determining whether the difficulty of the issues justifies an increase in the \$125 per hour limitation on the applicable hourly rate, the Internal Revenue Service will consider the following factors:

(1) The number of different provisions of law involved in each issue.

(2) The complexity of the particular provision or provisions of law involved in each issue.

(3) The number of factual issues present in the proceeding.

(4) The complexity of the factual issues present in the proceeding.

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

Example. Taxpayer A is represented by B, a CPA and attorney with a 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 that is 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 \$125 per hour limitation (as adjusted for the cost of living), absent a special factor. B is not a specially qualified representative because extraordinary knowledge of the tax laws does not constitute distinctive knowledge or a unique and specialized skill constituting a special factor. A special factor must be comprised of nontax expertise unless the taxpayer establishes the limited local availability of tax expertise.

* * * * *

(c) * * *

(4) * * *

Example 1. After incurring fees for representation during the Internal Revenue Service’s examination of taxpayer A’s income tax return, 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 before the date of the mailing of the 30-day letter are not reasonable administrative costs because they were incurred before the administrative proceeding date. Similarly, 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.

Example 2. Assume the same facts as in *Example 1* except that after A receives the notice of deficiency, A recontacts Appeals and Appeals agrees with A. If A seeks administrative costs, A may recover costs incurred after the date of the mailing of the 30-day letter, costs incurred in recontacting Appeals after the issuance of the notice of deficiency, and costs incurred up to the time the Tax Court petition was filed, as reasonable administrative costs, but only if the other requirements of section 7430 and the regulations thereunder are satisfied. The costs incurred before the date of the mailing of the 30-day letter are not reasonable administrative costs because they were incurred before the administrative proceeding date, as set forth in § 301.7430–3(c)(1)(iii). 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 they are litigation costs.

(d) *Pro bono services*—(1) *In general.* Fees recoverable under section 7430 and the regulations thereunder as reasonable administrative costs may exceed the attorneys’ fees paid or incurred by the prevailing party if these fees are less than the reasonable attorneys’ fees because an individual is representing the prevailing party on a *pro bono* basis. In addition to attorneys’ fees, reasonable costs incurred or paid by the individual providing the *pro bono* services that are normally billed separately also may be recovered under this section.

(2) *Requirements.* *Pro bono* representation is established by demonstrating—

(i) Legal services were provided for no fee or for a fee that (taking into account all the facts and circumstances) constitutes a nominal fee;

(ii) The legal services were provided to or on behalf of either—

(A) Persons of limited financial means who meet the eligibility requirements for programs funded by the Legal Services Corporation as set forth in 45 CFR 1611; or

(B) Organizations operating primarily to address the needs of persons with limited means if payment of a standard legal fee would significantly deplete the person’s financial resources; and

(iii) The service provider intended to perform services for no fee or for a nominal fee from the commencement of the representation. Intent to perform services for no fee or for a nominal fee may be demonstrated through documentation such as a retainer agreement. An individual will not be considered to have represented a client on a *pro bono* basis if the facts demonstrate that the individual anticipated a fee or provided services on a contingency fee basis. The fact that the service provider intended to seek recovery of fees under section 7430 will not prevent the service provider from satisfying this requirement.

(3) *Nominal fee.* A *nominal fee* is defined as one that is slight, inconsiderable or trifling (taking into account all the facts and circumstances).

(4) *Payment when services provided at no charge or for a nominal fee.* A prevailing party who receives legal services at no charge or for a nominal fee and who satisfies the requirements under this section is eligible to receive reasonable fees in excess of the fees actually paid or incurred and those otherwise meeting the requirements of this paragraph. Payment will be made to the representative or the representative’s employer.

(5) *Recordkeeping.* Contemporaneous records must be maintained, demonstrating the work performed and

the time allocated to each task. These records should contain similar information to billing records.

(6) *Hourly rate.* For purposes of this section, the hourly rate may not exceed the lesser of—

(i) The rate prescribed under section 7430(c)(1)(B); or

(ii) The hourly rate customarily charged by the representative in cases that are not handled on a *pro bono* basis.

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

Example 1. Taxpayer A, an attorney, files a petition with the Tax Court and pays a \$60 filing fee. A appears pro se in the court proceeding. If A prevails, he will not be entitled to an award of reasonable litigation costs for his services. A is rendering services on his own behalf, not providing *pro bono* representation. His lost opportunity costs are not compensable under section 7430. A may recover the filing fee as a litigation cost, but only if the other requirements of section 7430 and the regulations thereunder are satisfied.

Example 2. Taxpayer retains attorney B with regard to the audit of taxpayer’s individual income tax return. B agrees to represent taxpayer on a *pro bono* basis. Under this arrangement, taxpayer pays to attorney B a nominal fee. The customary hourly rate charged by B in cases not handled on a *pro bono* basis is less than the rate prescribed under section 7430(c)(1)(B). Any award paid to attorney B, or attorney B’s employer, would be limited to attorney B’s customary hourly rate. Thus, attorney B, or attorney B’s employer, would receive the customary hourly rate charged in cases not handled by attorney B on a *pro bono* basis rather than the nominal fee actually paid or incurred by the taxpayer.

Example 3. Assume the same facts in *Example 2* except that attorney B’s customary hourly rate exceeds the rate prescribed under section 7430(c)(1)(B). Any award paid to attorney B, or attorney B’s employer, would be made at the rate prescribed under section 7430(c)(1)(B).

Example 4. Organization C, a low income taxpayer clinic within the meaning of section 7526, agrees to represent taxpayer on a *pro bono* basis. Attorneys employed by C do not have a customary hourly rate and work exclusively for C. Any award paid to C, for representation by its attorneys, would be limited to the rate prescribed under section 7430(c)(1)(B).

§ 301.7430–5 [Amended]

Par. 7. For each entry in the table, redesignate the paragraph designated in the “Old Paragraph” column as the new paragraph designation in the “New Paragraph” column to read as follows:

Old paragraph	New paragraph
301.7430–5(a)(1)	301.7430–5(a)(2)
301.7430–5(a)(2)	301.7430–5(a)(3)
301.7430–5(a)(3)	301.7430–5(a)(4)
301.7430–5(c)	301.7430–5(d)(1)

Old paragraph	New paragraph
301.7430–5(c)(2)	301.7430–5(d)(6)
301.7430–5(c)(3)	301.7430–5(d)(7)
301.7430–5(d)	301.7430–5(e)
301.7430–5(e)	301.7430–5(f)(1)
301.7430–5(f)(1)	301.7430–5(g)(1)
301.7430–5(f)(2)	301.7430–5(g)(3)
301.7430–5(f)(3)	301.7430–5(g)(4)
301.7430–5(g)	301.7430–5(h)

Par. 8. Section 301.7430–5 is amended by:

1. Removing the language “only if—” at the end of the introductory text in paragraph (a) and adding the language “(other than by reason of section 7430(c)(4)(E)) only if—” in its place.

2. Adding new paragraphs (a)(1), (c), (d)(2), (d)(3), (d)(4), (d)(5), (g)(2) and (g)(5).

3. Revising paragraph (b).

4. Revising the third sentence and removing the language “(c)(3)” from the fourth sentence in newly-designated paragraph (d)(7) and adding the language “(d)(7)” in its place.

5. Revising the paragraph heading for newly-designated paragraph (f)(1) and adding new paragraph (f)(2).

6. Revising newly-designated paragraphs (g)(1) and (g)(3).

7. Removing the language “Internal Revenue Code” in the first sentence of newly-designated paragraph (g)(4) in both places.

8. Removing the language “such” in the first sentence of newly-designated paragraph (h) and adding the language “an” in its place.

9. Removing paragraph (h).

The additions and revisions read as follows:

§ 301.7430–5 Prevailing party.

(a) * * *

(1) At least one issue (other than recovery of administrative costs) remains in dispute as of the date that the Internal Revenue Service takes a position in the administrative proceeding, as described in paragraph (b) 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 earlier of—

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

(2) The date of the notice of deficiency or any date thereafter.

* * * * *

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

Example 1. Taxpayer A receives a notice of proposed deficiency (30-day letter). A pays the amount of the proposed deficiency and files a claim for refund. A's claim is considered and a notice of proposed claim disallowance is issued by the Area Director. A does not request an Appeals office conference and the Area Director issues a notice of claim disallowance. A then files suit in a United States District Court. A cannot recover reasonable administrative costs because the notice of claim disallowance is not a notice of the decision of the Internal Revenue Service Office of Appeals or a notice of deficiency. Accordingly, the Internal Revenue Service has not taken a position in the administrative proceeding pursuant to section 7430(c)(7)(B).

Example 2. Taxpayer B receives a notice of proposed deficiency (30-day letter). B disputes the proposed adjustments and requests an Appeals office conference. The Appeals office determines that B has no additional tax liability. B requests administrative costs from the date of the 30-day letter. B is not the prevailing party and may not recover administrative costs because all of the proposed adjustments in the case were resolved as of the date that the Internal Revenue Service took a position in the administrative proceeding.

(d) * * *

(2) *Position in courts of appeal.*

Whether the United States has won or lost an issue substantially similar to the one in the taxpayer's case in courts of appeal for circuits other than the one to which the taxpayer's case would be appealable should be taken into consideration in determining whether the Internal Revenue Service's position was substantially justified.

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

Example. 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 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.

(4) *Included costs.* (i) An award of reasonable administrative costs shall only include costs incurred on or after the earliest of—

(A) The date of the receipt by the taxpayer of the notice of decision from Appeals;

(B) The date of the notice of deficiency; or

(C) The date on which the first letter of proposed deficiency that allows the taxpayer an opportunity for administrative review in the Office of Appeals is sent.

(ii) If the Internal Revenue Service takes a position in an administrative proceeding, as defined in paragraph (b) of this section, and the position is not substantially justified, the taxpayer may be permitted to recover costs incurred before the position was taken, but not before the dates set forth in this paragraph (d)(4).

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

Example 1. Pursuant to section 6672, taxpayer D receives from the Area Director Collection Operations (Collection) a proposed assessment of trust fund taxes (Trust Fund Recovery Penalty). D requests and is granted Appeals office consideration. Appeals considers the issues and decides to uphold Collection's recommended assessment. Appeals notifies D of this decision in writing. Collection then assesses the tax and notice and demand is made. D timely pays the minimum amount required to commence a court proceeding, files a claim for refund, and furnishes the required bond. Collection disallows the claim, but Appeals, on reconsideration, reverses its original position, thus upholding D's position. If Appeals concedes its initial determination was not substantially justified, D may recover administrative costs incurred on or after the mailing of the proposed assessment of trust fund taxes, because the proposed assessment is the first determination letter that allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals.

Example 2. Taxpayer E receives a notice of proposed deficiency (30-day letter). E pays the amount of the proposed deficiency and files a claim for refund. E's claim is considered and a notice of proposed disallowance is issued by the Area Director. E requests and is granted Appeals office consideration. No agreement is reached with Appeals and the Office of Appeals issues a notice of claim disallowance. E does not file suit in a United States District Court but instead contacts the Appeals office to attempt to reverse the decision. E convinces the Appeals officer that the notice of claim disallowance is in error. The Appeals officer then abates the assessment. E may recover reasonable administrative costs if the position taken in the notice of claim disallowance issued by the Office of Appeals was not substantially justified and the other requirements of section 7430 and the regulations thereunder are satisfied. If so, E may recover administrative costs incurred from the mailing date of the 30-day letter because the requirements of paragraph (c)(2)

of this section are met. E cannot recover the costs incurred prior to the mailing of the 30-day letter because they were incurred before the administrative proceeding date.

* * * * *

(7) *Presumption.* * * * For purposes of this paragraph (d)(7), the term *applicable published guidance* means final or temporary regulations, revenue rulings, revenue procedures, information releases, notices and announcements published in the Internal Revenue Bulletin and, if issued to the taxpayer, private letter rulings, technical advice memoranda, and determination letters (§ 601.601(d)(2) of this chapter). * * *

* * * * *

(f) *Most significant issue or set of issues presented—*(1) *In general.* * * *

(2) *Example.* The provisions of this section may be illustrated by the following example:

Example. In the purchase of an ongoing business, Taxpayer F obtains from the previous owner of the business a covenant not to compete for a period of five years. On audit of F'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 F. 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 F asserts the basis is \$4X. The deduction for the seminar attended by F was reported on the return in question in the amount of \$7X. The Internal Revenue Service determines that the deduction for the seminar should be disallowed entirely. In the notice of deficiency, the Internal Revenue Service adjusts the amortization deduction to reflect the change to the basis of the covenant not to compete, and disallows the seminar expense. Thus, of the two adjustments determined for the year under audit, the adjustment attributable to the disallowance of the seminar is larger than that attributable to the covenant not to compete. Due to the impact on the next succeeding four years, however, the covenant not to compete adjustment is objectively the most significant issue to both F and the Internal Revenue Service.

* * * * *

(g) *Net worth and size limitations—*(1) *Individuals.* A taxpayer who is a natural person meets the net worth and size limitations of this paragraph if the taxpayer's net worth does not exceed two million dollars. The net worth limitation shall be determined for individuals using the fair market value of the individual's assets as of the administrative proceeding date. For purposes of determining net worth, individuals filing a joint return shall be treated as separate individuals. Thus,

individuals filing a joint return will each be subject to a separate net worth limitation of two million dollars.

(2) *Estates and trusts.* An estate or a trust meets the net worth and size limitations of this paragraph if the taxpayer's net worth does not exceed two million dollars. The net worth of an estate shall be determined using the fair market value of the assets of the estate as of the date of the decedent's death provided the date of death is prior to the date the court proceeding is commenced. The net worth of a trust shall be determined using the fair market value of the assets of the trust as of the last day of the last taxable year involved in the proceeding.

(3) *Others.* (i) A taxpayer that is a partnership, corporation, association, unit of local government, or organization (other than an organization described in paragraph (g)(4) of this section) meets the net worth and size limitations of this paragraph if, as of the administrative proceeding date:

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

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

(ii) A taxpayer who is a natural person and owns an unincorporated business is subject to the net worth and size limitations contained in paragraph (g)(3)(i) of this section if the tax at issue (or any interest, additional amount, addition to tax, or penalty, together with any costs in addition to the tax) relates directly to the business activities of the unincorporated business.

(4) * * *

(5) *Special rule for TEFRA partnership proceedings.* (i) In cases involving partnerships subject to the unified audit and litigation procedures of subchapter C of chapter 63 of the Internal Revenue Code (TEFRA partnership cases), the TEFRA partnership meets the net worth and size limitations requirements of this paragraph (g) if, on the administrative proceeding date—

(A) The partnership's net worth does not exceed seven million dollars; and

(B) The partnership does not have more than 500 employees.

(ii) In addition, each partner requesting fees pursuant to section 7430 must meet the appropriate net worth and size limitations set forth in paragraph (g)(1), (g)(2) or (g)(3) of this section. For example, if a partner is an individual, his or her net worth must not exceed two million dollars as of the administrative proceeding date. If the partner is a corporation, its net worth must not exceed seven million dollars and it must not have more than 500 employees.

Par. 9. Section 301.7430-6 is amended by revising the section heading and adding a new sentence at the end of the paragraph to read as follows:

§ 301.7430-6 Effective/applicability dates.

* * * Sections 301.7430-2(c)(3)(i)(B), (c)(3)(i)(E), (c)(3)(ii)(C), (c)(3)(iii)(C), (c)(5), (c)(7), (e); 301.7430-3(c)(1), (c)(4), (d); 301.7430-4(b)(3)(i), (b)(3)(iii)(B), (b)(3)(iii)(D), (b)(3)(iii)(E), (c)(4), (d); and 301.7430-5(a), (b), (c), (d)(2), (d)(3), (d)(4), (d)(5), (f)(2), (g)(1), (g)(2) and (g)(5), as proposed, apply to costs incurred and services performed as of the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

Par. 10. Section 301.7430-7 is amended by adding new paragraph (c)(8) and new *Examples 16* and *17* to paragraph (e) to read as follows:

§ 301.7430-7 Qualified offers.

* * * * *

(c) * * *

(8) *Interest as a contested issue.* To constitute a qualified offer, an offer must specify the offered amount of the taxpayer's liability (determined without regard to interest, unless interest is a contested issue in the proceeding), as provided in paragraphs (c)(1)(ii) and (c)(3) of this section. Therefore, a qualified offer generally may only include an offer to compromise tax, penalties, additions to the tax and additional amounts. Interest may only be included in a qualified offer if interest is a contested issue in the proceeding. For purposes of this section, interest is a contested issue in the proceeding only if the court in which the proceeding could be brought would have jurisdiction to determine the amount of interest due on the underlying tax, penalties, additions to the tax and additional amounts. Examples of proceedings in which interest might be a contested issue include proceedings in which the increased interest rate for large corporate underpayments under section 6621(c) is imposed by the Internal Revenue Service and interest abatement proceedings brought under section 6404. Interest is not a contested issue in the proceeding if the court that would have jurisdiction over the proceeding would not have jurisdiction to determine the amount or rate of interest, regardless of whether the taxpayer attempts to raise interest as an issue in the proceeding. Consequently, interest will not be a contested issue in the vast majority of tax cases because they merely involve the straight forward application of statutory interest under

section 6601. Accordingly, in those cases, interest may not be included in the offer.

* * * * *

(e) * * *

Example 16. Qualified offer may not compromise interest unless it is a contested issue. Taxpayer J receives a notice of deficiency making an adjustment resulting in a deficiency in tax of \$6,500 plus a penalty of \$500. Interest is not a contested issue in the proceeding. Within the qualified offer period, J submits a written offer to settle the case for a deficiency of \$1,000, including all taxes, penalties, and interest. The offer states that it is a qualified offer for purposes of section 7430(g) and that it will remain open for acceptance by the IRS for a period of 90 days. Section 7430(g)(2)(B) and paragraph (c)(3) of this section state that the amount of a qualified offer must be without regard to interest unless interest is at issue in the proceeding. Since J's offer attempts to compromise interest, which is not a contested issue in the proceeding, it is not a qualified offer.

Example 17. Qualified offer based on new defense or legal theory. Taxpayers K and L received a statutory notice of deficiency for tax year 2005, a tax year when they were married and filed a joint income tax return. Taxpayer K files a sole petition claiming innocent spouse relief and simultaneously submits an offer purporting to be a qualified offer. The offer states that K is entitled to innocent spouse relief and offers to settle the 2005 deficiency as to K in the amount of \$1,000. K's innocent spouse claim was not raised during K and L's audit, nor was it raised during their appeals conference. Additionally, at no time prior to or contemporaneously with submitting the offer did K file with the IRS a Form 8857, Request for Innocent Spouse Relief, or otherwise provide the information specified in § 1.6015-5(a) of this chapter. K's offer is not a qualified offer because K did not file a Form 8857 or otherwise provide substantiation or legal and factual arguments necessary to allow for informed consideration of the merits of the innocent spouse claim as required by paragraph (c)(4) of this section, contemporaneously with the offer or prior to making the offer.

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.
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National Park Service

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