Why Postappeal Mediation Isn't Working and How to Fix It

By Carolyn Miller Parr

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Postappeal mediation at the IRS is broken. I want to share my perspective (as a former Tax Court judge and current full-time mediator and arbitrator) on how it looks up close and personal and why it isn't working, and suggest how it can be fixed.

I have no experience with fast track because I am barred from that program. A taxpayer who wants to mediate after Exams and before Appeals must use a specially trained Appeals officer. This is not a criticism of Appeals-trained mediators. Those with whom I've comediated have operated by the book; that is, they've tried to be genuinely neutral even though their paychecks come from the IRS. The problem is that most taxpayers don't believe it.

In fact, the fundamental reason IRS mediation is not working is the deep lack of trust flowing both ways. The structures, which seem designed solely to protect the IRS from wily taxpayers, are practically foreordained to fail.

Bias Against Outside Mediators

The way a mediator is chosen is the opening problem. First, a taxpayer may bring in an outside mediator only after a case has gone through Appeals and positions have solidified. Second, the taxpayer must bear the mediator's full fee and expenses. And third, she (the mediator) is required to comediate with an IRS mediator. A comparison with ordinary commercial mediation — which is highly successful — is instructive here.

In commercial mediations (as in arbitrations) the parties choose a mediator together. They split her fee. The parties may not trust each other, but they both trust the mediator. In postappeal mediation, however, the Appeals negotiators will trust the Appeals mediator but not the outsider. The taxpayers will trust ''their'' mediator but won't speak candidly with the IRS in the room. This lack of trust stops in its tracks the open communication between participants and the mediator that is foundational to successful commercial mediation. So the comediators, no matter how well intentioned, are hamstrung before the opening whistle blows.

Solution: Allow the option of an outside mediator who would be jointly chosen by the taxpayer and the IRS and whose fee would be split. Whether this can happen in the context of fast track I don't know. But if taxpayers can't have an outside mediator at every stage, or if they're precluded by cost, they should at least have a voice in who their IRS-provided mediator will be, perhaps by choosing from a roster complete with credentials and experience.

Prohibition Against Ex Parte Contact

Another nail in the coffin is the IRS's prohibition against ex parte communication outside the actual mediation. This prohibition is embodied in the IRS standard mediation agreement, which a taxpayer desiring mediation must sign. The agreement also requires submission of premediation statements that must be exchanged. There is no provision for the filing of confidential settlement statements. These provisions serve no positive function and, indeed, impede settlement.

The first time I saw the standard agreement I was startled. A prohibition against confidential premediation conversations with each side is counter to standard mediation practice, both in private commercial mediations and in all federal and state court-sponsored programs of which I'm aware. In fact, in those situations communication is actively encouraged.

Presumably, the IRS wants to avoid the possibility of biasing the mediator. While I fully support a ban on ex parte contacts in trials and arbitrations, mediation is different. First, unlike with trials and arbitrations, private conversations are built into the mediation itself because the mediator almost always meets separately with each side, shuttling back and forth and holding confidential what each side tells her unless they give permission to share it. Second, one hopes the mediator has enough sophistication not to be prejudiced by what she hears. The ability to stay neutral is basic to the profession. Third, even if this were not the case, the mediator does not decide anything. The parties decide. Thus, the possible harm from premediation ex parte contacts is very slim, and the possible benefit is significant.

Ex parte communications allow the mediator, in complete confidence, to ask the parties questions such as these:

- ''What parts of your case will be hardest to prove?''
- ''What do you think are the other side's strongest points? How will you address them?''
- ''Which issues are most important to you?''
- ''Is your client in a realistic settlement mode?''
- ''Are there other unrelated things going on (like a threatened bankruptcy, labor union problems, a desire to protect company privacy or trade secrets) that will be affected by this?''

- ''What will you do if the mediation fails?'' (Mediation planning may vary depending on whether the next step is arbitration, Tax Court, the Court of Federal Claims, district court, or bankruptcy court.)
- And, most important, ''What are you willing to give up to get what you most want?''

That information is very helpful to the mediator in strategizing a successful battle plan. One problem, of course, is that in the case of comediation, both mediators would be on all calls. Very few taxpayers will answer those questions truthfully to an IRS employee, even if she is a mediator. But because ex parte contacts are not allowed, even an outside mediator is compelled to guess the whereabouts of the high ground to ascend and the quicksand to avoid.

Solution: Change the standard mediation agreement to allow premediation ex parte communication and encourage written confidential settlement statements that address the mediator's questions. By the way, the IRS has ruled internally that such contact would not seem to be prohibited by the Internal Revenue Service Restructuring and Reform Act of 1998 strictures on Appeals officers' ex parte contacts with Exams or counsel, which would not apply to a role as mediator. In a memorandum dated June 29, 1999, from Deborah A. Butler, then-assistant chief counsel to the national director of Appeals, counsel advised, ''We believe that the prohibitions of section 1001(a)(4) contemplates appeals officers acting in their settlement role capacity rather than acting as an arbitrator or mediator in an [alternative dispute resolution (ADR)] proceeding.'' (See PMTA 00269 (June 29, 1999), *Doc 2009-19226*, or *2009 TNT 164-7*.)

Unequal Incentives to Settle

One senior IRS Appeals officer told me he had participated in five postappeal mediations and none of them had settled. ''I'm afraid we get a little dug in,'' he said with a sheepish smile. A mediator knows she's in one of these situations when the government's opening remarks begin, ''We think we've been extremely reasonable and we don't have much else to say.'' Or, as one began, ''We've made our best offer.''

For settlement to happen, both sides have to see something in it for them. There is a huge power imbalance between the parties because taxpayers have much stronger motives to settle than do Appeals officers.

The taxpayer, of course, wants to save money. This includes not only taxes, but the potentially prohibitive cost of litigation. The taxpayer may be looking at hundreds of thousands of dollars in legal fees — or the threat of bankruptcy. The Appeals officer will get her salary whether she settles or not. She has nothing personal to lose.

A second goal of many taxpayers is to keep their confidential business confidential. In litigation, corporate tax returns become public, accessible by dissident shareholders, the media, competitors, and the neighbors. So do trade secrets. This can affect stock values or labor negotiations and attract negative attention from the SEC or other government agencies. The possible parade of horribles is endless: Alimony? Scare off possible corporate suitors? Negatively affect financing?

But under current postappeal procedures, an Appeals officer may have disincentives to settling. There's the very human ego thing, the desire to look good to his boss and his peers, as well as defense of his own work product. The Appeals officer may be angry he was forced to participate in a mediation when he has already given it his best shot and believes the taxpayer has been fairly served. His supervisor may look on a concession as an admission of error in the original offer. Or the Appeals officer may be criticized by Exams or counsel for giving away too much. Settling won't even reduce his caseload because whether the mediation ends in agreement or not, the case is on its way out his door. Why not hang tough?

Of course, the IRS as an agency does have settlement incentives: quicker collection of revenues, avoidance of negative precedents if a bad case is forced to trial, improved perception as being fair, and better future compliance from this taxpayer as part of a closing agreement. But these positive effects of settlements have not been communicated to all the troops, and no rewards for cooperation have been introduced.

Solution: Create an incentive for Appeals to want to settle, or at least remove the disincentives. The following are some possibilities:

1. To handle the issues of ego and saving face, a case slated for postappeal mediation should perhaps be transferred to a different Appeals officer solely for purposes of the mediation. The procedure of having the current officer's supervisor attend (with the power to overrule the officer) simply isn't working in practice. I had a supervisor tell me he thought the taxpayer might be right but that unless he was convinced beyond any doubt, he'd back his man.

2. Another possibility would be to transfer the case to a *litigator* in the Office of Chief Counsel. I stress litigator because the person needs to have a firm grasp of what's meant by ''hazards of litigation.'' Even though Appeals officers are knowledgeable about tax law, and some are attorneys, their understanding is theoretical. They don't have a gut feeling about standing in a courtroom and trying to defend a position that makes you look like a fool.

I mediated a matter in which the Appeals officer was convinced that the IRS had no hazards of litigation, in spite of a similar recent Tax Court case supporting the taxpayer. There were no hazards, he insisted, because ''the judge was wrong.'' Rest assured, a trial lawyer would instantly recognize that is not an argument one can make to a judge with a straight face.

3. IRS leaders could emphasize the institutional advantages of making mediation work. They could come up with some administrative carrots and sticks to encourage settlement. A carrot might be making settlement a positive factor to be considered in one's evaluation, for instance. In fast track, I'm told, if the mediator suggests a settlement and the taxpayer agrees but Exams does not, the Exams supervisor must write a report to his boss justifying the failure to agree. Something similar might be devised as a stick at the Appeals level.

4. A legislative solution could involve a shifting of attorney fees, although that would be harder to enact and would require more time and study. The administrative changes suggested above should be relatively quick and easy.

Finally, let me acknowledge that taxpayers are sometimes unrealistic in their assessments of the strength of their arguments and, in fact, the Appeals decision is often a fair final word. I don't mean to suggest otherwise. I also applaud the IRS's willingness to use ADR, even if it has not been universally accepted by taxpayers. Appeals is, in fact, a form of ADR that is working. But postappeals mediation is broken. It can and ought to be fixed with some simple changes. I hope that will happen.