Watch the Scope of Your IRS Closing Agreement

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The rules relating to delegated authority are complex. A taxpayer is well advised to ensure that the scope of a closing agreement the taxpayer signs is what the taxpayer expects, and that an IRS official who signs the agreement has authority to do so for the matters in the agreement.

In *Amgen Inc. v. Commissioner*,[1] the IRS increased Amgen's taxable income by adjusting transfer prices between it and its foreign subsidiary, Amgen Manufacturing, Limited ("AML") for taxable years 2007-2009. AML was an indirectly owned Bermuda corporation with a principal place of business in Puerto Rico. The IRS and Amgen memorialized the transfer pricing adjustments in a closing agreement, which stated:

"This agreement does not prevent further allocations under [IRC] § 482 with respect to taxable events involving Amgen and AML that are attributable to taxable periods of Amgen for which allocations are not determined by this agreement."

Amgen filed its returns for taxable years 2010-2012 (Docket No. 16017-21) and 2013-2015 (Docket No. 15631-22) using the transfer pricing method reflected in the 2007-2009 closing agreement.[2] The IRS rejected that method for both subsequent audit cycles, which resulted in income tax deficiencies that Amgen challenged in Tax Court. Amgen's theory was that it had reasonably relied on the transfer pricing method in the 2007-2009 closing agreement for its tax returns for the subsequent audit cycles, and this reliance compelled the IRS under the due process clause[3] to apply the transfer pricing method described in the 2007-2009 closing agreement to both subsequent audit cycles. The essence of the due process argument was that the IRS could not change the previously approved transfer pricing method without prior notice. The taxpayer moved for summary judgment based on the due process argument.[4]

Tax Court Decision: Not surprisingly, the court rejected the taxpayer's due process reasonable-reliance argument because the closing agreement for taxable years 2007-2009 expressly provided that the agreement did not prevent the IRS from making transfer pricing adjustments for future years. In short, the closing agreement was not comparable to a formal administrative rule on which a taxpayer could reasonably rely.[5] Amgen thus had no reason to rely on the closing agreement for future taxable years and prevent the IRS from collecting tax that is lawfully due.[6]

The court did not discuss whether the IRS operating division, Large Business and International ("LB&I"), or the Appeals Office had delegated authority to affect Amgen's tax liability for any taxable year after 2007-2009 – the years that were the subject of the closing agreement. The Tax Court said that it could not decide the summary judgment motion on any basis other than the due process argument. Perhaps it was incorrect, although the mistake, if any, probably would not have affected the outcome of the case.

Delegated Authority: LB&I and the Appeals Office have authority to affect a taxpayer' s tax liability for a taxable year only if they have delegated authority to take that action. The Tax Court might have concluded that, based on delegated authority, LB&I or the Appeals Office – whichever signed the closing agreement – could not possibly have taken action to affect the tax liability of any taxable year subsequent to taxable years 2007-2009 at the time that the 2007-2009 closing agreement was signed.

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LB&I Directors of Field Operations and International, and appeals team chiefs with respect to their team cases have delegated authority to sign a closing agreement "*for matters under their respective jurisdictions.*" The delegated authority is "to enter into and approve a written agreement with any person relating to the internal revenue tax liability of such person … for a taxable period or periods ended prior to the date of agreement *and related specific items affecting other taxable periods.*"[7]

Matters Under Their Jurisdiction: If, as of the date of the 2007-2009 closing agreement, the taxable periods 2013-2015 had ended, LB&I and the Appeals Office could sign a closing agreement that fixed the transfer pricing method in taxable years 2013-2015 *if* LB&I or the Appeals Office, as the case may be, had jurisdiction over those taxable years. If taxable years 2013-2015 had not been assigned to LB&I for examination, or if Amgen had not protested proposed transfer pricing determinations to the Appeals Office for those taxable years, LB&I and the Appeals Office would have lacked jurisdiction to affect the tax liabilities for those years.

Future Years: The IRS chief counsel advises that the language, "related specific items affecting other taxable periods" permits a determination of the tax treatment of a future taxable year, that is a taxable year after the date of the closing agreement, "if the closing agreement provides for the tax treatment and if the issue is recurring (providing later tax treatment will not depend on factual circumstances of later years)." According to the chief counsel, this language means that "the transaction resolved in a closing agreement for one year necessitates a binding effect on that taxpayer's liability in another year." The requirement of the binding effect is based on the theory that each taxable year stands on its own.[8]

An example of a binding effect of a closing agreement for a "specific item" is a determination of the tax basis of a block of stock, some shares of which are sold in the year under examination and the balance in a future year. An allocation of the basis to the shares that are sold necessitates a binding effect on the tax basis of the shares that remain.[9]

Since facts relating to transfer pricing can vary from year to year, it would seem that LB&I and the Appeals Office would not have delegated authority over a year subsequent to the date of the closing agreement. The Tax Court did not discuss any evidence showing that selection of a transfer pricing method for 2007-2009 "necessitated a binding effect" for subsequent taxable years.

Chief Counsel Delegated Authority: If, as of the date of the 2007-2009 closing agreement, the subsequent taxable years had not yet ended, neither LB&I nor the Appeals Office had delegated authority to agree to a transfer pricing method for taxable years 2013-2015. That authority resides in the Chief Counsel.[10]

Apparent Authority: Finally, even if an agent of the IRS who signs a closing agreement has apparent authority if not actual authority, the agreement may well be unenforceable because the doctrine of apparent authority generally does not apply to the United States Government.[11]

If you have questions about tax related matters and IRS developments, please contact your Miller Canfield attorney or one of the authors of this alert.

[1] Docket Nos. 16017-21; 15631-22 (U.S.T.C. July 3, 2024).

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[2] Examples of transfer pricing methods are the comparable uncontrolled price method, the resale price method, the cost plus method, the comparable profits method, and the profit split method. Treas. Reg. §1.482-3(a), (1) – (5).

[3] U.S. Const. amend. V: "No person shall … be deprived of … property without due process of law."

[4] The motion applied only to the Tax Court petition for the 2013-2015 taxable years.

[5] Even if the closing agreement had stated that the transfer pricing method used to calculate the income adjustments for 2007-2009 was the "best method," the court doubted that the closing agreement would have had any bearing on the transfer pricing method for future taxable years. *Amgen*, at fn. 3. Amgen had invested in expert witnesses to prove that the method it proposed to calculate the transfer pricing adjustments in the 2007-2009 closing agreement was the best method. The IRS's use of a different method that did not apply the expert evidence for subsequent taxable years may well explain Amgen's assertion that the IRS unfairly surprised it.

[6] Dickman v. Comm'r, 465 U.S. 330, 343 (1984). *Cf.* Schering-Plough Corp. v. U.S., 2007 WL 4264542, at 5 (D.N. J.,2007) ("Dickman holds that the IRS cannot be barred from collecting a tax that is lawfully due solely because it previously made an erroneous decision.").

[7] Delegation Order 8-3, par. 5 (LB&I), par. 14 (appeals office).

[8] Chief Counsel Advisory 2012-22038 (June 1, 2012). *See also* Chief Counsel Advisory 2008-02031 (Jan. 11, 2008).

[9] Treas. Reg. §301.7121-1(b)(4).

[10] The Chief Counsel has authority to sign a closing agreement in respect to any prospective transactions or completed transactions if the request to the Chief Counsel for determination or ruling was "made before any affected returns have been filed." Delegation Order 8-3, paragraph 2.

[11] Chief Counsel Advisory - 2008-02031, citing *Heckler v. Community Health Serv., Inc.*, 467 U.S. 51, 63 n.17 (1984), for the rule that the government cannot be bound by the ultra vires acts of its representatives. But note that in *Community Health*, the Court also stated that "we are hesitant, when it is unnecessary to decide this case, to say that there are no cases in which the public interest in ensuring that the Government can enforce the law free from estoppel might be outweighed by the countervailing interest of citizens in some minimum standard of decency, honor, and reliability in their dealings with their Government." 467 U.S. at 60-61.