

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.

[T.D. 8542, 59 FR 29362, June 7, 1994]

§ 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 ex-

pert, 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, in the case of proceedings commenced after July 30, 1996, \$110 per hour increased by a cost of living adjustment (and if appropriate, a special factor adjustment).

(ii) *Cost of living adjustment*. The Internal Revenue Service will make a cost of living adjustment to the \$110 per hour limitation for fees incurred in any calendar year beginning after December 31, 1996. The cost of living adjustment will be an amount equal to \$110 multiplied by the cost of living adjustment determined under section 1(f)(3) for the calendar year (substituting “calendar year 1995” for “calendar year 1992” in section 1(f)(3)(B)). If the dollar limitation as adjusted by this cost of living increase is not a multiple of \$10, the dollar amount will be rounded to the nearest multiple of \$10 (rounding up if the amount is a multiple of \$5).

(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 \$110 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 \$110 per hour limitation. The limited availability of a specially qualified representative for the proceeding does constitute a special factor justifying an increase in the \$110 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 \$110 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 \$110 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

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\$110 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 \$110 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 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 rea-

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sonable administrative costs, as those are litigation costs.

[T.D. 8542, 59 FR 29363, June 7, 1994, as amended by T.D. 8725, 62 FR 39118, July 22, 1997]

§ 301.7430-5 Prevailing party.

(a) *In general.* For purposes of an award of reasonable administrative costs under section 7430 in the case of administrative proceedings commenced after July 30, 1996, a taxpayer is a prevailing party only if—

(1) The position of the Internal Revenue Service was not substantially justified;

(2) The taxpayer substantially prevails as to the amount in controversy or with respect to the most significant issue or set of issues presented; and

(3) The taxpayer 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