

beyond the end of the qualified offer period.

(d) [Reserved]

(e) *Examples.* The following examples illustrate the provisions of this section:

Example 1. Definition of a judgment. The Internal Revenue Service (IRS) audits Taxpayer A for year X and issues a notice of proposed deficiency (30-day letter) proposing to disallow deductions 1, 2, 3, and 4. A files a protest and participates in a conference with the Internal Revenue Service Office of Appeals (Appeals). Appeals allows deduction 1, and issues a statutory notice of deficiency for deductions 2, 3, and 4. A's petition to the United States Tax Court for year X never mentions deduction 2. Prior to trial, A concedes deduction 3. After the trial, the Tax Court issues an opinion allowing A to deduct a portion of deduction 4. As used in paragraph (a) of this section, the term judgment means the cumulative determinations of the court concerning the adjustments at issue in the court proceeding. Thus, the term judgment does not include deduction 1 because it was never at issue in the court proceeding. Similarly, the term judgment does not include deduction 2 because it was not placed at issue by A in the court proceeding. Although deduction 3 was at issue in the court proceeding, it is not included in the term judgment because it was not determined by the court, but rather by concession or settlement. For purposes of section 7430(c)(4)(E), the term judgment only includes the portion of deduction 4 disallowed by the Tax Court.

Example 2. Liability under the offer and liability under the judgment. Assume the same facts as in *Example 1* except that A makes a qualified offer after the Appeals conference, which is not accepted by the IRS. A's offer is with respect to all adjustments at issue at that time. Those adjustments are deductions 2, 3, and 4. At the conclusion of the litigation, A's entitlement to an award based upon the qualified offer will depend, among other things, on a comparison of the change in A's liability for income tax for year X resulting from the judgment of the Tax Court with the change that would have resulted had the IRS accepted A's qualified offer. In making this comparison, the term judgment (as discussed in *Example 1*) is modified by including the amounts of settled or conceded adjustments that were at issue at the time the qualified offer was made. Any settled or conceded adjustments that were not at issue at the time the qualified offer was made, either because the settlement or concession occurred before the offer or because the adjustment was not raised until after the offer, are not included in the comparison. Thus, A's offer on deductions 2, 3, and 4 is compared with the change in A's liability resulting from the Tax Court's determination of deduction 4, and the concessions of issues 2 and 3 by A.

Example 3. Offer must resolve full liability. Assume the same facts as in *Example 2* except that A's offer after the Appeals conference explicitly states that it is only with respect to adjustments 2 and 3 and not with respect to adjustment 4. Even if A's liability pursuant to the judgment, calculated

under paragraph (b)(3) of this section as illustrated in *Example 2*, is equal to or less than it would have been had the IRS accepted A's offer after the Appeals conference, A is not a prevailing party under section 7430(c)(4)(E). A qualified offer must include all adjustments at issue at the time the offer is made. Since A's offer excluded adjustment 4, which was an adjustment at issue at the time the offer was made, it does not constitute a qualified offer pursuant to paragraph (b)(2) of this section.

Example 4. Offer must resolve full liability. Assume the same facts as in *Example 1*, except that A makes a qualified offer that is accepted by the IRS. After the offer is accepted, A attempts to reduce the amount A will pay pursuant to the offer by applying net operating loss carryovers to the years in issue. Because the net operating losses were not at issue when the offer was made, A's offer was a qualified offer. Whether A is entitled to apply net operating losses to reduce the amount stated in the offer will depend upon the application of contract principles, local court rules, and, because net operating losses are at issue, section 6511(d) and related provisions.

Example 5. Qualified offer rule for multiple tax years, partial resolution offer is a qualified offer. Taxpayer B receives a notice of deficiency for taxable years 2001, 2002, and 2003. For 2001, the statutory notice disallows business deductions. For 2002, the statutory notice increases income for unreported lottery winnings. For 2003, the statutory notice disallows a child care credit. B submits a qualified offer only with respect to 2002. Since the adjustments for the three tax years are separate and distinct, B may submit a qualified offer for a single year. If B's liability under the judgment is equal to or less than the qualified offer with respect to 2002, irrespective of 2001 and 2003, B is a prevailing party for 2002 for purposes of section 7430(g). Assuming B satisfies the remaining requirements of section 7430, B may recover reasonable administrative and litigation costs that are attributable to 2002 from the date of the qualified offer. To qualify for any costs with respect to 2001 or 2003, B must satisfy the requirements of section 7430(c)(4).

Example 6. Qualified offer rule for multiple tax years, partial resolution offer is not a qualified offer. Assume the same facts as in *Example 5* except that with respect to 2002, in addition to increasing B's income for the unreported lottery winnings, the statutory notice also disallows a charitable contribution deduction. B submits a settlement offer that purports to be a qualified offer, but only covers the unreported lottery winnings. B's offer is not a qualified offer because it does not address the charitable contribution issue, and thus, does not fully resolve B's liability for 2002.

Example 7. Qualified offer rule for multiple tax years, partial resolution offer is not a qualified offer. Taxpayer C receives a notice of deficiency for taxable years 2001, 2002, and 2003 adjusting the amount of a depreciation deduction due to the Internal Revenue Service's increase to the recovery period. C submits a settlement offer relating only to 2003 that purports to be a qualified

offer. C's offer is not a qualified offer because the issue in the three tax years is not separable given that the treatment of the issue in one of the years necessarily affects the treatment of the issue in the other years, and C's offer only applies to one of the years in the proceeding. In cases involving multiple tax years with nonseparable tax issues affecting all tax years, an offer is not a qualified offer unless it resolves the liability for all tax years at issue in the administrative or judicial proceeding.

Example 8. Qualified offer rule inapplicable when all issues settled. Taxpayer D receives a notice of proposed deficiency (30-day letter) proposing to disallow both a personal interest deduction in the amount of \$10,000 (Adjustment 1), and a charitable contribution deduction in the amount of \$2,000 (Adjustment 2), and to include in income \$4,000 of unreported interest income (Adjustment 3). D timely files a protest with Appeals. At the Appeals conference, D presents substantiation for the charitable contribution and presents arguments that the interest paid was deductible mortgage interest and that the interest received was held in trust for Taxpayer E. At the conference, D also provides the Appeals officer assigned to D's case a written offer to settle the case for a deficiency of \$2,000, exclusive of 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 in excess of 90 days. After considering D's substantiation and arguments, the Appeals Officer accepts the \$2,000 offer to settle the case in full. Although D's offer is a qualified offer, because all three adjustments contained in the qualified offer were settled, the qualified offer rule is inapplicable.

Example 9. Qualified offer rule inapplicable when all issues contained in the qualified offer are settled; subsequently raised adjustments ignored. Assume the same facts as in *Example 8* except that D's qualified offer was for a deficiency of \$1,800 and the IRS rejected that offer. Subsequently, the IRS issued a statutory notice of deficiency disallowing the three adjustments contained in *Example 8*, and, in addition, disallowing a home office expense in the amount of \$5,000 (Adjustment 4). After petitioning the Tax Court, D presents the field attorney assigned to the case with a written offer, which is not designated as a qualified offer for purposes of section 7430(g), to settle the three adjustments that had been the subject of the qualified offer, plus adjustment 4, for a total deficiency of \$2,500. After negotiating with D, a settlement is reached on the three adjustments that were the subject of the rejected qualified offer, for a deficiency of \$1,800. Adjustment 4 is litigated in the Tax Court and the court determines that D is entitled to the full \$5,000 deduction for that adjustment. Consequently, a decision is entered by the Tax Court reflecting the \$1,800 settlement amount, which matches exactly the amount of D's only qualified offer in the case. Although the determined liability for adjustments 1, 2, and 3 equals that of the rejected qualified offer, because all three adjustments contained in the qualified offer