TAX CONTROVERSIES: PRACTICE AND PROCEDURE (3rd ed. 2009)

2015 Supplement

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Chapter 1

§ 1.02 (STRUCTURE OF THE IRS)

At the end of 2013, the Senate confirmed John Koskinen as the most recent IRS Commissioner. Among his top priorities are improving taxpayer compliance, ensuring adequate funding for the IRS, and implementing the Affordable Care Act. Alison Bennett, *Koskinen Says Improved Compliance, Ensuring Funding Are Top IRS Priorities*, 4 BNA DAILY TAX REP. G-4 (Jan. 8, 2014). Commissioner Koskinen noted that working to restore the American public's trust in the IRS in the wake of a controversy surrounding the handling of applications for tax-exempt status is also a priority. *Id*.

The controversy arose in May of 2013 after statements made by Lois Lerner, then director of the Tax-Exempt and Governmental Entities (TE/GE) Division, that IRS employees had identified for scrutiny the applications for declaration of tax-exempt status under Code section 501(c)(4) of groups with names containing "words like 'Tea Party,' 'patriot,' or '9/12 Project.'" Fred Stokeld et al., *EO Scandal Rocks IRS*, 139 TAX NOTES 829 (2013). (Section 501(c)(4) provides tax-exempt status for "[c]ivic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes," where "no part of the net earnings of such entity inures to the benefit of any private shareholder or individual." Existing Treasury Regulations provide that promotion of social welfare "does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office." Treas. Reg. § 1.501(c)(4)-1(a)(iii).)

Lerner's remarks predated a Treasury Inspector General for Tax Administration (TIGTA) report by only a few days. The report cited mismanagement and incompetence by some at the TE/GE Division. TIGTA, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review*, Ref. No. 2013-10-053 (May 14, 2013). These events were followed by

> the resignations of acting IRS Commissioner Steven Miller and TE/GE Commissioner Joseph Grant; Miller's replacement by Office of Management and Budget Controller Daniel Werfel; announcement of investigations by the IRS's inspector general and at least a half-dozen congressional committees, and a

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criminal probe by the Justice Department; public outrage, especially on the right; and a mad scramble for damage control by the Obama administration.

Stokeld et al., *supra*, at 829.

Eventually, Ms. Lerner retired from the IRS, but Congressional inquiries continued. Josh Hicks, *Central Figure in IRS Tea Party Controversy Resigns*, WASHINGTON POST.COM (Sept. 23, 2013). Republican and Democratic representatives on the House Appropriations Committee dispute whether IRS officials focused primarily on conservative-leaning political groups for scrutiny or whether progressive groups seeking tax-exempt status under section 501(c)(4) received as much scrutiny. Fred Stokeld, *Congressional Actions Over EO Controversy Persist*, 140 TAX NOTES 873, 874 (2013). The controversy followed concerns about disclosure of return information in contravention of Code section 6103; that issue is discussed in Section 6.03 of this Supplement.

The IRS and Treasury Department responded to the controversy by issuing new proposed regulations that define "candidate-related" political activity for purposes of qualifying for exemption under section 501(c)(4). Reg-134417-13, *Notice of Proposed Rulemaking: Guidance for Tax Exempt Social Welfare Organizations on Candidate-Related Political Activities*, Fed. Reg. 71,535 (Nov. 29, 2013). To qualify, the social welfare organization must still be organized primarily for a social welfare purpose, but candidate-related political activity is not considered a social welfare purpose. *Id.*

The proposed regulations proved controversial. *Koskinen Clarifies IRS's Plans for 501(c)(4) Regs*, 2014 TAX NOTES TODAY 75-2 (Apr. 18, 2014). The IRS received more than 150,000 public comments on the proposal, expressing, among other concerns, that the proposed regulations would infringe on organizations' free speech rights and treat nonpartisan voter education drives as political activity. Fred Stokeld, *IRS Will Probably Repropose Social Welfare Regs, Koskinen Says*, 2014 TAX NOTES TODAY 73-1 (Apr. 16, 2014). IRS Commissioner Koskinen stated that the IRS would likely rewrite the controversial proposed regulations, William Hoffman, *Koskinen Clarifies IRS's Plans for 501(c)(4) Regs*, 2014 TAX NOTES TODAY 75-2 (Apr. 18, 2014) but, as of press time, no revisions have been issued. Legislation introduced in the Senate would prevent the proposed regulations from taking effect. *See* Stop Targeting of Political Beliefs by the IRS Act of 2015, S. 283. Related legislation approved by the House of Representatives would encompass various political activities within the phrase "promotion of social welfare." *See* A Bill To Prohibit the Department of the Treasury From Assigning Tax Statuses to Organizations Based on Their Political Beliefs and Activities, H.R. 1798 (2015).

The House of Representatives has passed a flurry of legislation designed to prevent the IRS from potentially targeting tax-exempt organizations based on their political leanings. *House Passes Two Bills Designed to Prevent IRS Targeting*, 2014 TAX NOTES TODAY 38-7 (Feb. 26, 2014). The Taxpayer Transparency and Efficient Audit Act, H.R. 2530, for example, would require the IRS to inform a taxpayer when it shares that person's tax information with another government agency and would limit the duration of an IRS audit. *Id.* The Protecting Taxpayers from Intrusive IRS Requests Act, H.R. 1059, introduced in 2015, would bar the IRS from asking about an individual's religious, political, or social views. *Id.*

Another TIGTA report also cited excessive spending on conferences for IRS employees. TIGTA, *Review of the August 2010 Small Business/Self-Employed Division's Conference in Anaheim, California*, Ref. No. 2013-10-037 (May 31, 2013), *available at* http://www.treasury.gov/tigta/auditreports/2013reports/201310037fr.html. According to the report, the IRS spent a total of $49 million on 225 conferences from fiscal year 2010 through fiscal year 2012. *Id.* One 2010 conference in California cost $4.1 million and included questionable expenses such as hotel upgrades and gifts for attendees. *Id.* The same report criticized the agency for spending $50,000 in production costs to create videos for a conference with the theme "Leading Into the Future" of IRS employees line dancing and a parody of *Star Trek* with IRS employees portraying various characters. *Id.* Congressional hearings on these matters continue. *See* Lindsey McPherson et al., *Second W&M Hearing on EO Scandal Further Divides Committee*, 139 TAX NOTES 1237 (2013).

On a more technical note, in 2010, the IRS changed the name of and reorganized the former Large and Mid-Size Business Division. I.R.S. News Release IR-2010-88 (Aug. 4, 2010), *available at* http://www.irs.gov/uac/IRS-Realigns-and-Renames-Large-Business-Division,-Enhances-Focus-on-International-Tax-Administration. It is now the Large Business and International (LB&I) Operating Division. The division continues to handle corporations and partnerships with assets greater than $10 million and also handles most of the IRS's international tax compliance efforts. A more recent restructuring of the LB&I Division, effective October 1, 2012, aligns the division's operations even more with a geographic model, although the various industry segments will remain. Amy S. Elliott, *LB&I Realigns Domestic Operations, APMA Program*, 138 TAX NOTES 30 (2013).

In 2014, the IRS announced that it will realign compliance operations serving individual and small business taxpayers. According to a news release, pre-filing compliance programs will move to the Wage and Investment division and post-filing compliance will move to the Small Business/Self-Employed division. IRS, *IRS to Realign Compliance Operations* (Oct. 16, 2014), *available at* http://www.irs.gov/uac/Newsroom/IRS-To-Realign-Compliance-Operations. According to the agency, "The concept . . . would realign compliance-related operations to avoid organizational duplications, find operational efficiencies and help more quickly identify emerging compliance risks. For taxpayers and tax professionals, the goal is improved customer service and easier contact for handling their issues." *Id*. Some commentators maintain that the realignment is being driven by dwindling IRS budgets and efforts by the agency to reduce costs. *See* William Hoffman, *IRS Compliance Realignment Seen as Sign of Budget Woes*, 145 TAX NOTES 188 (2014). That article reports that certain experienced practitioners believe that:

> centralizing those functions across various divisions runs contrary to the goals of the [Internal Revenue Service Restructuring and Reform Act of 1998], which sought to align

> services such as audit and compliance to the needs of various taxpayer groups. Most U.S. businesses file their returns on Form 1040 and attach a Schedule C, . . ., which is one reason why wage and investment are part of the same division. Under the realignment, . . . the same W&I compliance employees may be required to work on the tax problems of small businesses, large corporations, the self-employed, and tax-exempt and other organizations.

Id. at 189.

§ 1.05[A][1] (Voluntary Compliance Estimates)

In December 2011, the IRS released updated tax gap estimates. These are the most recent estimates the IRS has released, though they are for tax year 2006. The overall voluntary compliance rate reflected in the 2011 "Tax Gap Map" remained largely unchanged at 83.1 percent, but the gross tax gap grew to an estimated $450 billion. *See* IRS, *Tax Gap "Map" Year 2006* (2011), *available at* http://www.irs.gov/pub/newsroom/tax_gap_map_2006.pdf (hereinafter, *Tax Gap Map*). "The IRS said the growth in the overall tax gap was 'largely in line with the growth in total tax liabilities,' which increased from $2.11 trillion in 2001 to about $2.66 trillion in 2006. Part of the growth was also due to better methods of measuring the gap, the agency said." Eric Kroh, *New Tax Gap Estimates Show Compliance Largely Unchanged*, 34 TAX NOTES 299, 299 (2012).

An estimated $376 billion of the gross tax gap is attributable to underreporting, $46 billion from underpayment, and $28 billion from failure to file. *See Tax Gap Map*, *supra*. Of the $376 billion attributed to underreporting, $235 billion is attributable to the individual income tax, $72 billion to employment taxes, $67 billion to the corporate income tax, and $2 billion to the estate tax. *See id*. The new tax gap map did not include an estimate of underreported excise taxes. *See id*. Underreported individual income tax still constitutes the majority of the $450 billion gross tax gap, at 52 percent.[1]

Back in July 2009, the IRS released a plan to tackle the tax gap. *See* U.S. Dep't of the Treasury, *Update on Reducing the Federal Tax Gap and Improving Voluntary Compliance* (July 8, 2009), *available at* http://www.irs.gov/pub/newsroom/tax_gap_report_-final_version.pdf. It provided an update on the seven-component strategy outlined in previous tax gap reports. Those components were:

1. Reduce Opportunities for Evasion

2. Make a Multi-Year Commitment to Research

3. Continue Improvements in Information Technology

4. Improve Compliance Activities

5. Enhance Taxpayer Service

[1] $235 billion divided by $450 billion.

6. Reform and Simplify the Tax Law

7. Coordinate with Partners and Stakeholders.

Id. at 5.

The 2009 report described a number of enforcement and other initiatives, including a focus on offshore tax evasion. *See id.* at 11. Since 2009, the IRS has engaged in a well-publicized crackdown on offshore evasion and has offered three "voluntary disclosure" initiatives focused on offshore evasion—in 2009, 2011, and an indefinite one in 2012. *See* Leandra Lederman, *The Use of Voluntary Disclosure Initiatives in the Battle Against Offshore Tax Evasion*, 57 VILL. L. REV. 499, 500–01 (2012) (describing and critiquing the initiatives). On June 18, 2014, the IRS made further revisions to the Offshore Voluntary Disclosure Program (OVDP), including streamlining its procedures. The changes include:

- Requiring additional information from taxpayers applying to the program;
- Eliminating the existing reduced penalty percentage for certain non-willful taxpayers in light of the expansion of the streamlined procedures;
- Requiring taxpayers to submit all account statements and pay the offshore penalty at the time of the OVDP application;
- Enabling taxpayers to submit voluminous records electronically rather than on paper;
- Increasing the offshore penalty percentage (from 27.5% to 50%) if, before the taxpayer's OVDP pre-clearance request is submitted, it becomes public that a financial institution where the taxpayer holds an account or another party facilitating the taxpayer's offshore arrangement is under investigation by the IRS or Department of Justice.

I.R.S. News Release IR-2014-73 (June 18, 2014), *available at* http://www.irs.gov/uac/Newsroom/IRS-Makes-Changes-to-Offshore-Programs;-Revisions-Ease-Burden-and-Help-More-Taxpayers-Come-into-Compliance.

In April 2012, a GAO representative testified before the House Committee on Oversight and Government Reform Subcommittee on Government Organization, Efficiency, and Financial Management about its April 19, 2012 tax compliance study, GAO-12-651T. *See GAO Recommends Measures to Improve Compliance*, 2012 TAX NOTES TODAY 77-19 (Apr. 20, 2012). In its testimony, GAO recommended the following strategies requiring action on the part of the IRS or Congress:

> **Enhancing information reporting by third parties to IRS** could reduce tax evasion and help taxpayers comply voluntarily. However, identifying additional reporting opportunities can be challenging because third parties may not have accurate information available in a timely manner. Also, adding reporting requirements creates burdens for both third parties and IRS.
>
> **Ensuring high-quality services to taxpayers**, such as by telephone and

> correspondence or online, can help taxpayers who wish to comply with tax laws but do not understand their obligations. However, tax law changes and funding priorities have recently affected IRS's ability to provide quality taxpayer services.
>
> **Devoting additional resources to enforcement** would enable IRS to contact millions of potentially noncompliant taxpayers it identifies but cannot contact. To determine the appropriate level of enforcement resources, policymakers would need to consider how to balance taxpayer service and enforcement activities and how effectively and efficiently IRS currently uses its resources.
>
> **Expanding compliance checks before IRS issues refunds** would involve matching information returns to tax returns during, rather than after, the tax filing season. This approach would require a major reworking of some fundamental IRS computer systems but could help address identity theft-related fraud and allow IRS to use enforcement resources on other compliance problems.
>
> **Leveraging external resources, such as paid tax return preparers and whistleblowers**, can help improve tax compliance because paid preparers' actions have an enormous impact on IRS's ability to effectively administer tax laws, and whistleblowers provide IRS information on suspected noncompliance.
>
> **Modernizing information systems** would allow IRS to post more comprehensive tax return information to its computer systems, which could facilitate the examination process and expedite taxpayer contacts for faster resolution.
>
> **Simplifying the tax code** could help taxpayers understand and voluntarily comply with their tax obligations and limit opportunities for tax evasion.

Tax Gap: Sources of Noncompliance and Strategies To Reduce It: Hearing Before the Subcomm. on Gov't Org., Efficiency, & Fin. Mgmt. of the H. Comm. on Oversight and Gov't Reform, 112th Cong. (2012), *available at* http://www.gao.gov/assets/600/590215.pdf (statement of James R. White, Dir. of Strategic Issues, GAO).

At the same hearing, the Inspector General for Tax Administration testified on the IRS's efforts to combat the tax gap and the challenges it faces in that regard. His testimony concluded:

> [T]he IRS's current strategy for reducing the Tax Gap, which is largely dependent on funding for additional compliance resources and legislative changes, is not enough. The IRS recognizes that to make meaningful improvement in voluntary compliance and to reduce the Tax Gap, it will require a long-term, focused effort encompassing taxpayer service, modernization, and enforcement, accompanied by

> broader simplification and reform of the tax code and significant advances in compliance technology. One of the primary challenges facing the IRS is improving research to better understand the current sources of noncompliance and to determine what actions are most effective in addressing taxpayer noncompliance.

TIGTA Says IRS Tax Gap Strategy is Insufficient, 2012 TAX NOTES TODAY 77-36 (Apr. 20, 2012).

Also in 2012, National Taxpayer Advocate Nina Olson surveyed two groups of sole proprietors, one identified by DIF scores as most compliant, and the other as least compliant, in an effort to try to identify causes of noncompliance. *Olson Details IRS's Hurricane Response, Virtual Service Delivery Pilot*, 2012 TAX NOTES TODAY 217-9 (Nov. 8, 2012). "The survey found that there is a 'very strong correlation between noncompliance and distrust of government, distrust of the IRS, and distrust of the tax code,' Olson said, adding, 'There's very strong agreement that the IRS is more interested in collecting money than in listening to the taxpayer and solving problems.'" *Id.*

In August 2013, TIGTA issued yet another report on the tax gap, *The Internal Revenue Service Needs to Improve the Comprehensiveness, Accuracy, Reliability, and Timeliness of the Tax Gap Estimate* (Aug. 21, 2013), *available at* http://www.treasury.gov/tigta/iereports/2013reports/ 2013IER008fr.pdf. That report made three overall findings: First, because the IRS and Treasury use tax gap figures to track progress toward the goal of increasing voluntary compliance, the estimates should be updated more frequently. *Id.* at 2. Second, the individual income tax gap should include estimates for offshore evasion and the informal economy. *Id.* And third, the method for estimating corporate tax noncompliance needs improvement. *Id.* TIGTA also made seven specific recommendations for action by the Director of the Office of Research, Analysis, and Statistics:

> (1) conduct a study to determine the feasibility of providing interim updates of the Tax Gap estimate; (2) develop a process and procedures to ensure compliance with the applicable OMB [Office of Management and Budget] standards [*Standards and Guidelines for Statistical Surveys*]; (3) issue a published report to explain the methods, assumptions, and premises used to develop the estimates; (4) develop the capability to estimate the Tax Gap for the informal economy; (5) perform a study to determine the feasibility of creating an estimate of the Tax Gap due to offshore tax evasion; (6) consider modifying the estimation model for large corporations from using recommended tax from operational examinations to tax assessments from operational examinations; and (7) consider conducting a National Research Program review on small corporations filing Form 1120, *U.S. Corporate Income Tax Return*, with total assets of less than $10 million.

Id. at 3. The IRS generally agreed with these recommendations. *Id.* The report stated that the IRS agreed in full with recommendations (1), (2), (3), and (5). With respect to the fourth recommendation, the IRS agreed to perform a feasibility study to estimate the contribution to the tax gap of the income of informal suppliers. On the sixth and seventh recommendations, the IRS is studying alternative approaches to estimating large corporations' noncompliance and is conducting a small-sample National Research Program review of corporations with less than $250,000 in assets and will examine the feasibility of conducting larger studies. *Id.*

In her 2013 annual report, Nina Olson (the National Taxpayer Advocate) stated that a "taxpayer bill of rights" could enhance revenue collection and close the tax gap:

> The U.S. tax system is built on voluntary compliance. The IRS estimates that it collects 85.5 percent of all tax owed. Of that amount, 98 percent is paid timely and voluntarily. Only two percent derives from late and enforced collection actions.
>
> For the government, voluntary compliance is much cheaper than enforced compliance, because the government does not have to spend money to collect amounts that are voluntarily paid. Thus, the IRS's overriding goal is to maximize voluntary compliance.
>
> Taxpayer rights are central to voluntary compliance. If taxpayers believe they are treated, or can be treated, in an arbitrary and capricious manner, they will mistrust the tax system and be less likely to comply with the laws voluntarily. If taxpayers have confidence in the fairness and integrity of the system, they will be more likely to comply.

1 TAXPAYER ADVOCATE SERV., ANNUAL REPORT TO CONGRESS 5 (2013), *available at* http://www.taxpayeradvocate.irs.gov/userfiles/file/2013FullReport/Volume-1.pdf. The IRS adopted a "taxpayer bill of rights" on June 10, 2014. The rights include:

1. The Right to Be Informed
2. The Right to Quality Service
3. The Right to Pay No More than the Correct Amount of Tax
4. The Right to Challenge the IRS's Position and Be Heard
5. The Right to Appeal an IRS Decision in an Independent Forum
6. The Right to Finality
7. The Right to Privacy
8. The Right to Confidentiality
9. The Right to Retain Representation
10. The Right to a Fair and Just Tax System

I.R.S. News Release IR-2014-72 (June 10, 2014), *available at* http://www.irs.gov/uac/Newsroom/IRS-Adopts-Taxpayer-Bill-of-Rights;-10-Provisions-to-be-Highlighted-on-IRSgov,-in-Publication-1.

In her 2014 report to Congress, Ms. Olson stated that the increasingly limited service the IRS provides taxpayers is the number-one most serious problem:

> The most serious problem facing U.S. taxpayers is the declining quality of service provided to them by the IRS when they seek to comply with their federal tax filing and payment obligations. As part of the IRS Restructuring and Reform Act of 1998, Congress directed the IRS "to place a greater emphasis on serving the public and meeting taxpayers' needs." The IRS took this directive to heart and substantially improved its taxpayer services in the aftermath of that Act. Due to a widening imbalance between the IRS's increasing workload and its diminishing resources, however, taxpayer service levels have been declining, and in 2015, taxpayers are likely to receive the worst levels of service since the IRS implemented its current performance measures in 2001.
>
> By eliminating tax preparation services at TACs and inadequately supporting VITA/TCE sites, the IRS makes it more difficult for taxpayers to get tax preparation assistance that helps them meet their reporting obligations and comply with the tax laws. These shortcomings burden taxpayers, may cause taxpayers to pay more tax than they should or seek assistance from unqualified or unscrupulous preparers, thereby undermining voluntary compliance and eroding the taxpayer's rights to be informed, to quality service, and to pay no more than the correct amount of tax.

1 TAXPAYER ADVOCATE SERV., SUMMARY ANNUAL REPORT TO CONGRESS 1, 6 (2014), *available at* http://www.taxpayeradvocate.irs.gov/Media/Default/Documents/2014-Annual-Report-to-Congress-Executive-Summary.pdf.

Also in 2014, TIGTA released a report on how expansion of the Delinquent Return Refund Hold program could reduce the tax gap. TREASURY INSPECTOR GEN. FOR TAX ADMIN., EXPANSION OF THE DELINQUENT RETURN REFUND HOLD PROGRAM COULD IMPROVE FILING COMPLIANCE AND HELP REDUCE THE TAX GAP (2014), *available at* http://www.treasury.gov/tigta/auditreports/2014reports/201430023fr.pdf. (Under that program, the IRS delays issuing a tax refund for up to six months while investigating a delinquency for another tax year. *See id.* at 2.) In this report, TIGTA recommended that the IRS expand the scope of the program, resources permitting, *id.* at 12, and that the IRS develop performance measures to evaluate the effect of the program on compliance, *id.* at 14. The IRS agreed with both recommendations, but did not adopt specific plans to implement them. *Id.* at 12–14.

The IRS Oversight Board's annual Taxpayer Attitude Survey provides another perspective on the tax gap. The following chart shows the answer to the question "How much, if any, do you think is an acceptable amount to cheat on your income taxes? (*in percentage*)":

	2014	**2013**	**2012**	**2011**	**2010**	**2009**	**2008**	**2007**	**2006**	**2005**
A little here and there	6	7	7	6	8	9	6	8	8	7
As much as possible	5	5	4	8	4	4	3	5	4	3
Not at all	86	86	87	84	87	84	89	84	86	88
Don't know/ Not asked/ No reply	2	2	2	3	2	3	3	3	1	2

IRS Oversight Board 2014 Taxpayer Attitude Survey 20 (2014), *available at* http://www.treasury.gov/IRSOB/reports/Documents/IRSOB%20Taxpayer%20Attitude%20Survey%202014.pdf (hereinafter, *2014 Taxpayer Attitude Survey*).

The chart above suggests that public opinion on the acceptability of tax cheating has not changed much over the past few years. *Cf.* Karlyn Bowman & Jennifer Marsico, *Public Opinion on Taxes: Holding Steady*, 143 TAX NOTES 717 (2014) (looking at other tax issues, such as perceptions of the IRS and perceived tax burden). The numbers in each row for the past few years are very similar, and the "not at all" response was between 84 percent and 87 percent in the six-year period spanning 2009 and 2014. *2014 Taxpayer Attitude Survey*, *supra*, at 20. Looking back a few years to 2011, the percent responding "as much as possible," to the question of how much it is acceptable to cheat, doubled—going from 4 percent to 8 percent—compared to the two previous years, but then it dropped back to 4 percent in 2012 before rising slightly to 5 percent in 2013 and remaining at 5 percent in 2014. *2014 Taxpayer Attitude Survey*, *supra*, at 20. "The margin of error on weighted data is +/- 4.0% for the total sample at the 95% confidence level." *Id.* at 17.

§ 1.05[A][2] (Enforcement Statistics)

In fiscal years 2008 and 2009, the IRS's audit rate for individuals declined, reaching 1.0 percent in 2009. *IRS, Examination Coverage: Recommended and Average Recommended Additional Tax After Examination, by Type and Size of Return, Fiscal Year 2009*, *available at* http://www.irs.gov/pub/irs-soi/09db09aex.xls [hereinafter, *Examination Coverage 2009*]. In fiscal year 2010, the individual audit rate rose to 1.1 percent, and stayed steady in fiscal year

2011. *See Internal Revenue Service 2010, Data Book* 22, *available at* http://www.irs.gov/pub/irs-soi/10databk.pdf [hereinafter, *Data Book 2010*]; IRS, *Examination Coverage: Recommended and Average Recommended Additional Tax After Examination, by Type and Size of Return, Fiscal Year 2011*, *available at* http://www.irs.gov/taxstats/article/0,,id=207306,00.html [hereinafter, *Examination Coverage 2011*]. However, in fiscal year 2012, the individual audit rate declined to 1 percent. *See Examination Coverage: Recommended and Average Recommended Additional Tax After Examination, by Type and Size of Return, Fiscal Year 2012*, *available at* http://www.irs.gov/pub/irs-soi/12db09aex.xls [hereinafter, *Examination Coverage 2012*]. During fiscal year 2013, the individual audit rate fell slightly below 1%, to .96%, "reflecting the realities of an agency that is trying to make do with less." Eric Kroh, *IRS Individual Audit Rate Fell Below 1 Percent in Fiscal 2013*, 142 TAX NOTES 168, 168 (2014). In 2014, the IRS audited only .86% of individuals, the lowest audit rate since 2004. Richard Rubin, *IRS: Audits of U.S. Businesses Decline to Lowest Level Since 2005*, DAILY TAX REP. (BNA), Mar. 2, 2015, at G-3.

The IRS reported in 2012 that it was auditing high-income individuals at a higher rate than other individuals. *See* William Hoffman, *Nearly 1 in 8 High-Income Taxpayers Audited, IRS Reports*, 2012 TAX NOTES TODAY 4-3 (Jan. 6, 2012). In fiscal year 2011, 12.48 percent of individual taxpayers with incomes of $1 million or higher were subject to audit, while only 3.93 percent of taxpayers with incomes between $200,000 and $999,000 were audited. IRS, FISCAL YEAR 2013 ENFORCEMENT AND SERVICE RESULTS 3 (2014), *available at* http://www.irs.gov/PUP/newsroom/FY%202013%20Enforcement%20and%20Service%20Results%20--%20WEB.pdf. Among individual taxpayers with incomes under $200,000, only 1.02 percent were subject to audit. *Id.* All of these rates declined in 2012 and 2013. *See id.* In 2013, 10.85 percent of individuals with incomes of $1 million or higher were audited, compared with 3.26 percent of individuals in the middle range (incomes of $200,000 to $999,000) and .88 percent of individuals in the low range (incomes less than $200,000). *Id.* These percentages declined in 2014, when the audit rate for persons who earn more than $1 million was around 7.5 percent, and the audit rate for individuals in the middle range was around 2.2 percent. Ben Steverman, *IRS Has New Favorite People to Audit As Volume of Investigations Declines*, DAILY TAX REP. (BNA), Apr. 9, 2015, at G-1. For an economic analysis of taxpayer audit probability, see J.T. Manhire, *Toward a Perspective-Dependent Theory of Audit Probability for Tax Compliance Models*, 33 VA. TAX REV. 629 (2014).

With respect to corporate taxpayers, audits of corporations with assets under $10 million were the same in 2009 and 2010 as they were in 2007, at .9 percent. *Examination Coverage 2009*, *supra*; *Data Book 2010*. In 2011, audits of such corporations increased to 1 percent, *Examination Coverage 2011*, *supra*, and they increased again in 2012, to 1.1 percent, *Examination Coverage 2012*, *supra*. In 2013, such small corporations were audited at a slightly lower rate, 1 percent. IRS, *Data Book 2013*, at 22 (2014) [hereinafter *Data Book 2013*], *available at* http://www.irs.gov/pub/irs-soi/13databk.pdf. This percentage remained the same in 2014. IRS, *Data Book 2014,* at 23 (2015) [hereinafter, *Data Book 2014*], *available at* http://www.irs.gov/pub/irs-soi/14databk.pdf.

Audits of corporations with assets over $10 million decreased to 14.5 percent in 2009. *Examination Coverage 2009*, *supra*. However, the number of audits of corporations with assets over $10 million increased from 16.6 percent in 2010, *Data Book 2010*, *supra*; to 17.6 percent in 2011, *Examination Coverage 2011*, *supra*; and to 17.8 percent in 2012, *Examination Coverage 2012*, *supra*. The rate declined to 15.8 percent in 2013—the lowest audit rate of large corporations since 2009. *Data Book 2013*, *supra*, at 22. This rate dropped further in 2014, to 12.2 percent. *Data Book 2014*, *supra*, at 23. By contrast, corporations with $250 million or more in assets saw an audit rate increase from 2012 (29.4 percent) to 2013 (33.7 percent). John Keenan & Diana Hoshall, *IRS Fiscal Year 2013 Enforcement and Service Results, Delayed Implication of LB&I Information Requests Enforcement Policy, Uncertain Tax Position Filing Statistics for Fiscal Year 2012 and* Loving *Court of Appeals Decision*, J. TAX PRAC. & PROC., Feb.-Mar. 2013, at 9, 10. This trend did not continue in 2014, when the IRS audited only 26 percent of businesses with $250 million or more in assets. Richard Rubin, *IRS: Audits of U.S. Businesses Decline to Lowest Level Since 2005*, DAILY TAX REP. (BNA), Mar. 2, 2015, at G-3.

In early 2014, Heather Maloy, the Commissioner of the Large Business & Internal Division of the IRS said that the IRS's approach to audits of large corporations has been evolving toward a more tailored approach. Alison Bennett, *IRS Confronting Challenges, Revamping Enforcement Initiatives in Coming Year*, DAILY TAX REP. (BNA), Jan. 28, 2014, at S-10. The IRS sometimes skips a year with some corporate taxpayers in the large case program and redirects audit resources to other taxpayers, including some that have not previously been audited. *Id.*

TIGTA statistics show a fairly steady increase in Notices of Federal Tax Lien filed each year between 2006 and 2010, ending with approximately 1,096,000 liens filed in 2010. *See* TIGTA, *Trends in Compliance Activities Through Fiscal Year 2010*, Ref. No. 2011-30-071 (July 18, 2011) at 31, *available at* http://www.treasury.gov/tigta/auditreports/2011reports/201130071fr.pdf. However, filings decreased slightly in 2011, to 1,042,230, and plummeted to 707,768 in 2012. IRS, *Delinquent Collection Activities, Fiscal Years 2011 and 2012*, *available at* www.irs.gov/file_source/pub/irs-soi/12db16co.xls [hereinafter, *Delinquent Collection Activities, Fiscal Years 2011 and 2012*]. In 2013, the lien filing rate dropped again, to 602,005. IRS, Delinquent Collection Activities, Fiscal Years 2012 and 2013 [hereinafter *Delinquent Collection 2012–13*], *available at* http://www.irs.gov/file_source/pub/irs-soi/13db16co.xls. Once again, in 2014, the lien filing rate dropped, this time to 535,580. IRS, *Delinquent Collection Activities, Fiscal Years 2013 and 2014* [hereinafter *Delinquent Collection 2013-14*].

Levies hit a five-year low in 2008, then rebounded in 2009 and 2010, with approximately 3,606,000 in 2010. TIGTA, Compliance Trends, *supra*. In 2011, the number of levies increased slightly, to 3,748,884, but in 2012, the number dropped to 2,961,162. Delinquent Collection Activities, Fiscal Years 2011 and 2012, *supra*. The number of levies dropped even lower in

2013, to 1,855,095. *Delinquent Collection 2012–13*, *supra*. In 2014, the number increased slightly, to 1,995,987. *Delinquent Collection 2013-14*, *supra*. Seizures tended to decrease over that period, with 776 seizures in fiscal year 2011 and 733 in 2012, 547 in 2013, and only 432 in 2014. *Id*.

Enforcement revenue increased steadily from 2002 to 2007, then began to fluctuate. *See* IRS, *Fiscal Year 2012 Enforcement and Service Results* 1, *available at* http://www.irs.gov/PUP/newsroom/FY%202013%20Enforcement%20and%20Service%20Results%20--%20WEB.pdf [hereinafter *2013 Enforcement Results*]. The IRS collected $59.2 billion in enforcement revenue in 2007. *Id.* An IRS spokesperson described 2007 as "a record-breaking year for enforcement" involving "a few large corporate closures and cases closed out during tax shelter inventories." Lauren Gardner, *IRS 2008 Enforcement Data Show Decline in Enforcement Revenue, Effects of Stimulus*, DAILY TAX REP. (BNA), Dec. 23, 2008, at G-1. Enforcement revenue declined in fiscal years 2008 and 2009, to $48.9 billion in 2009, which is close to the 2006 levels. *See* Michael Joe, *Enforcement Revenues Decline Because of Economic Downturn*, 126 TAX NOTES 63, 63 (2010). In 2010, enforcement revenue increased to $57.6 billion, but in 2011, it dropped to $55.2 billion, *2013 Enforcement Results*, *supra,* at 1.

Enforcement revenue further declined in 2012, to $50.2 billion, but it increased in 2013, to $53.35 billion. *Id.* The increase in revenue in 2013 was primarily due to an increase in revenue at Appeals, which increased by $2.63 billion from 2012 to 2013. Keenan & Hoshall, *supra*, at 10 ("It is interesting to note that the increased enforcement revenue collected in FY 2013 was achieved with the lowest level of staffing for key enforcement positions in the past ten years."). In 2014, enforcement revenue increased to $57.15 billion. IRS, *Fiscal Year 2014 Enforcement and Service Results* 1, *available at* http://www.irs.gov/PUP/newsroom/FY2014%20Enforcement%20and%20Service%20Results%20--%20web%20version.pdf. The increase is in spite of Commissioner Koskinen's report that "reduced staffing in enforcement will result in at least 46,000 fewer individual and business audit closures and more than 280,000 fewer Automated Collection System and Field Collection case closures, and that the government will lose up to two billion that would have otherwise been collected. Claudia A. Hill, *A Note From the Editor-In-Chief*, J. TAX PRAC. & PROC. Dec. 2014-Jan. 2015, at 3, 4.

§ 1.05[B] (Approaches to Tax Compliance)

Australia pioneered a "responsive regulation" approach that involves a range of targeted agency responses. *See, e.g.*, IAN AYRES & JOHN BRAITHWAITE, RESPONSIVE REGULATION: TRANSCENDING THE DEREGULATION DEBATE (1992); John Braithwaite, *The Essence of Responsive Regulation*, 44 U.B.C. L. REV. 475 (2011); *see also* JOHN BRAITHWAITE, MARKETS IN VICE, MARKETS IN VIRTUE (2005). Responsive regulation involves a more cooperative and tailored set of responses to taxpayers:

> Because cooperative, problem-solving enforcement is always cheaper than contentious negotiations and eventual litigation—for private parties and government agencies alike—responsive regulation proponents argue that each regulator-regulatee relationship should start in a respectful, cooperative manner. If a particular regulatee does not respond to this approach, the regulator should gradually switch to increasingly adversarial enforcement. The metaphor of an iron fist in a velvet glove aptly describes this strategy.

Alex Raskolnikov, *Revealing Choices: Using Taxpayer Choice to Target Tax Enforcement*, 109 COLUM. L. REV. 689, 735 (2009).

The "responsive regulatory pyramid" is perhaps the best-known aspect of the responsive regulation approach. *See* Braithwaite, *supra*, at 480. For articles on how this approach may be useful in the United States, see, *e.g.*, Rachelle Y. Holmes, *Forcing Cooperation: A Strategy for Improving Tax Compliance*, 79 U. CIN. L. REV. 1415 (2011); Sagit Leviner, *A New Era of Tax Enforcement: From "Big Stick" to Responsive Regulation*, 42 U. MICH. J. L. REFORM 381 (2009).

For evaluations of responsive regulation, see, *e.g.*, Steven A. Dean, *Tax Deregulation*, 86 N.Y.U. L. REV. 387, 426 (2011) ("Deregulatory tax reforms neither promote economic efficiency nor vindicate important liberty interests, and it is unclear whether they simplify tax law. Nevertheless, deregulatory reforms that embrace the teachings of the responsive regulation literature may be valuable."); Judith Freedman, *Responsive Regulation, Risk, and Rules: Applying the Theory to Tax Practice*, 44 U.B.C. L. REV. 627, 628–29 (2012) ("conclud[ing] by suggesting that the theory of responsive regulation has great value in tax administration but also the potential for misfiring in this area unless applied and used only where appropriate legal safeguards are provided."); Leigh Osofsky, *Some Realism About Responsive Tax Administration*, 66 TAX L. REV. 121, 178 (2012) ("[W]e must get beyond the promise of responsive tax administration and give a good, hard look into whether responsive tax administration is working as promised in United States large business.").

The IRS currently uses the cooperative compliance model with certain large corporate taxpayers in its Compliance Assurance Process (CAP). Professor Leigh Osofsky has critiqued CAP and cautioned against excessive "optimism in the tax compliance literature regarding responsive tax administration's ability to change tax compliance from a game of catch-me-if-you-can to a sustained commitment to meeting tax obligations with integrity." Osofsky, *supra*, at 140. Tax Notes reported that the number of CAP taxpayers is not expected to grow significantly from its August 2014 level of 185 taxpayers. *See* Mindy Herzfeld, *Does Cooperative Compliance Have a Future at the IRS?*, 144 TAX NOTES 762, 762–63 (2014). According to the Herzfeld article, the departure of certain LMSB personnel, including former IRS LB&I Deputy Commissioner (International) Michael Danilack, may stymie LB&I's use of cooperative compliance techniques in the international arena. *Id.*

§ 1.05[C] (Where Do We Go From Here?)

For recommendations of ways to increase compliance with personal income taxes, based on the U.S. experience, see George K. Yin, *Principles and Practices to Enhance Compliance and Enforcement of the Personal Income Tax*, 31 VA. TAX REV. 381 (2012). Other recent work on tax compliance includes the following: Edward W. Afield, *A Market For Tax Compliance*, 62 CLEV. ST. L. REV. 315 (2014) (arguing that the IRS could obtain "compliance gains . . . by restructuring its preparer regulatory regime as one of voluntary compliance certifications."); Joshua D. Blank, *Collateral Compliance*, 162 U. PA. L. REV. 719 (2014) (discussing the use of non-tax collateral sanctions for tax noncompliance); Allison Christians, *Avoidance, Evasion, and Taxpayer Morality*, 44 WASH. U. J. L. & POL'Y 39 (2014) (arguing that it is critical for the media and activists to distinguish between legal tax avoidance and illegal tax evasion rather than using the language of morality to conflate them); Leandra Lederman & Ted Sichelman, *Enforcement as Substance in Tax Compliance*, 70 WASH. & LEE L. REV. 1679 (2013) (modeling the effect of imperfect enforcement on overall social utility when changing the substantive tax laws is not possible); Susan C. Morse, T*ax Compliance and Norm Formation Under High-Penalty Regimes*, 44 CONN. L. REV. 675 (2012) (providing a "comprehensive theory of tax compliance and norm formation under high-penalty regimes from the starting point of a non-compliance norm"); and Leigh Z. Osofsky, *Concentrated Enforcement*, 15 FLA. TAX REV. 325 (2014) (arguing that rotating crackdowns can be a useful allocation of scarce enforcement resources).

Chapter 2

§ 2.02[A][2][a] (Which Deference Standard Applies, *Chevron* or *National Muffler*?)

Replace the existing text in Section 2.02[A][2][a] with the following:

In *United States v. Mead Corp.*, 533 U.S. 218 (2001), discussed in more detail in Section 2.02[B], the U.S. Supreme Court set forth a test for when *Chevron* deference should apply to an agency interpretation. According to the Court, *Chevron* deference applies

> when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority. Delegation of such authority may be shown in a variety of ways, as by an agency's power to engage in adjudication or notice-and-comment rulemaking, or by some other indication of a comparable congressional intent.

Id. at 226–27. *Mead* did not involve tax regulations, but the Court's analysis suggested that the *Chevron* deference standard, if it applied to tax regulations, would apply to Treasury regulations that went through the notice and comment procedures, regardless of whether they might be considered legislative or interpretive.

Although the Court had several opportunities after *Mead* to state definitively whether *Chevron* or the traditional *National Muffler* rule applied to tax regulations, it avoided the question for a while. *See, e.g.*, Boeing Co. v. United States, 537 U.S. 437 (2003) (failing to discuss either *Chevron* or *National Muffler*, despite the lower court's reliance on *Chevron*). Debate continued among lower courts about the appropriate standard. In *Swallows Holding v. Commissioner*, 515 F.3d 162 (3d Cir. 2008), for example, the Third Circuit reversed the Tax Court's holding that *National Muffler* applied to interpretive tax regulations, finding that, based on the Court's analysis in *Mead*, *Chevron* deference should apply.

In 2011, the Supreme Court finally spoke to the deference issue in *Mayo Foundation for Medical Education and Research v. United States,* 562 U.S. 44 (2011). At the same time, the Court also considered the question of whether both interpretive and legislative tax regulations warrant *Chevron* deference. The Court in *Mayo* considered the validity of tax regulations promulgated under Code section 7805 that provided that medical residents who work more than 40 hours per week are not "students" for purposes of Code section 3121 and therefore not exempt from federal payroll taxes. The Court referred to these regulations as the "full-time employee rule."[2]

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[2] In a more recent decision, the National Labor Relations Board (NLRB) ruled that Northwestern University football players are "employees" who can unionize. *See* Northwestern Univ., Case No. 13-RC-121359 (NLRB Mar. 26, 2014) (decision of Regional Director), *available at* http://taxprof.typepad.com/files/nlrb.pdf. That decision could open the door for the IRS to argue that the players' "scholarships" are actually taxable payments for services. *See* Paul Caron, *Northwestern*

The Court first found that the language in Code section 3121 was ambiguous and therefore open to reasonable agency interpretation. *Id.* at 52. The Court then moved to the second step of the *Chevron* analysis:

> In the typical case, such an ambiguity would lead us inexorably to *Chevron* step two, under which we may not disturb an agency rule unless it is "'arbitrary or capricious in substance, or manifestly contrary to the statute.'" . . . In this case, however, the parties disagree over the proper framework for evaluating an ambiguous provision of the Internal Revenue Code.
>
> Mayo asks us to apply the multi-factor analysis we used to review a tax regulation in *National Muffler*, 440 U.S. 472 . . . . There we explained:
>
>> A regulation may have particular force if it is a substantially contemporaneous construction of the statute by those presumed to have been aware of congressional intent. If the regulation dates from a later period, the manner in which it evolved merits inquiry. Other relevant considerations are the length of time the regulation has been in effect, the reliance placed on it, the consistency of the Commissioner's interpretation, and the degree of scrutiny Congress has devoted to the regulation during subsequent re-enactments of the statute. *Id.*, at 477 . . . .
>
> The Government, on the other hand, contends that the *National Muffler* standard has been superseded by *Chevron*. The sole question for the Court at step two under the *Chevron* analysis is "whether the agency's answer is based on a permissible construction of the statute." 467 U.S., at 843 . . . .
>
> Since deciding *Chevron*, we have cited both *National Muffler* and *Chevron* in our review of Treasury Department regulations. . . .

Athletes May Face Big Tax Hit from Unionization Victory, TAXPROF BLOG (Mar. 28, 2014), http://taxprof.typepad.com/taxprof_blog/2014/03/northwestern-athletes.html (quoting Darren Rovell, *Players Could Get Big Tax Bill*, ESPN.COM (Mar. 27, 2014), http://espn.go.com/college-football/story/_/id/10683398/tax-implications-create-hurdle-players-union. This decision could also result in the taxation of all grant-in-aid scholarships. *See* Justin Morehouse, *When Play Becomes Work: Are College Athletes Employees?*, 144 TAX NOTES 1427 (2015). However, on April 24, 2014, a majority of the NLRB voted to grant review of the Regional Director's decision in the case as it raised "substantial issues warranting review" and announced that it would shortly issue a notice establishing a schedule for the filing of briefs and requesting participation by *amici curiae*. *Northwestern Univ.*, Case No. 13-RC-121359 (NLRB Apr. 24, 2014) (NLRB order), *available at* https://www.nlrb.gov/news-outreach/news-story/nlrb-grants-request-review-northwestern-university-athletes-case. As this Supplement goes to press, all interested parties have filed briefs but the Board's decision in the case is still pending. *See Full Coverage of Northwestern's Football Unionization Effort*, THE DAILY NORTHWESTERN (Evanston, Ill.), July 20, 2015, http://dailynorthwestern.com/sports/northwestern-nlrb-union-effort/.

Although we have not thus far distinguished between *National Muffler* and *Chevron*, they call for different analyses of an ambiguous statute. Under *National Muffler*, for example, a court might view an agency's interpretation of a statute with heightened skepticism when it has not been consistent over time, when it was promulgated years after the relevant statute was enacted, or because of the way in which the regulation evolved . . . . The District Court in this case cited each of these factors in rejecting the Treasury Department's rule, noting in particular that the regulation had been promulgated after an adverse judicial decision . . . .

Under *Chevron*, in contrast, deference to an agency's interpretation of an ambiguous statute does not turn on such considerations. We have repeatedly held that "[a]gency inconsistency is not a basis for declining to analyze the agency's interpretation under the *Chevron* framework." *National Cable & Telecommunications Assn.* v. *Brand X Internet Services*, 545 U.S. 967, 981 . . . (2005); . . . . We have instructed that "neither antiquity nor contemporaneity with [a] statute is a condition of [a regulation's] validity." *Smiley* v. *Citibank (South Dakota), N. A.*, 517 U.S. 735, 740 . . . (1996). And we have found it immaterial to our analysis that a "regulation was prompted by litigation." *Id.*, at 741 . . . . Indeed, in *United Dominion Industries, Inc.* v. *United States*, 532 U.S. 822, 838 . . . (2001), we expressly invited the Treasury Department to "amend its regulations" if troubled by the consequences of our resolution of the case.

Aside from our past citation of *National Muffler*, Mayo has not advanced any justification for applying a less deferential standard of review to Treasury Department regulations than we apply to the rules of any other agency. In the absence of such justification, we are not inclined to carve out an approach to administrative review good for tax law only. To the contrary, we have expressly "[r]ecogniz[ed] the importance of maintaining a uniform approach to judicial review of administrative action." . . . .

The principles underlying our decision in *Chevron* apply with full force in the tax context. *Chevron* recognized that "[t]he power of an administrative agency to administer a congressionally created . . . program necessarily requires the formulation of policy and the making of rules to fill any gap left, implicitly or explicitly, by Congress." [*Chevron*,] 467 U.S., at 843 . . . (internal quotation marks omitted). It acknowledged that the formulation of that policy might require "more than ordinary knowledge respecting the matters subjected to agency regulations." *Id.*, at 844 . . . (internal quotation marks omitted). Filling gaps in the Internal Revenue Code plainly requires the Treasury Department to make interpretive choices for statutory implementation at least as complex as the ones other agencies must make in administering their statutes. . . . We see no reason why our review of tax regulations should not be guided by agency expertise pursuant to *Chevron* to the same extent as our review of other regulations.

As one of Mayo's *amici* points out, however, both the full-time employee rule and the rule at issue in *National Muffler* were promulgated pursuant to the Treasury Department's general authority under 26 U.S.C. § 7805(a) to "prescribe all needful rules and regulations for the enforcement" of the Internal Revenue Code. . . . In two decisions predating *Chevron*, this Court stated that "we owe the [Treasury Department's] interpretation less deference" when it is contained in a rule adopted under that "general authority" than when it is "issued under a specific grant of authority to define a statutory term or prescribe a method of executing a statutory provision." *Rowan Cos.* v. *United States*, 452 U.S. 247, 253 . . . (1981); *United States* v. *Vogel Fertilizer Co.*, 455 U.S. 16, 24 . . . (1982) (quoting *Rowan*).

Since *Rowan* and *Vogel* were decided, however, the administrative landscape has changed significantly. We have held that *Chevron* deference is appropriate "when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority." *Mead*, 533 U.S., at 226–227 . . . . Our inquiry in that regard does not turn on whether Congress's delegation of authority was general or specific. For example, in *National Cable & Telecommunications Assn.*, *supra*, we held that the Federal Communications Commission was delegated "the authority to promulgate binding legal rules" entitled to *Chevron* deference under statutes that gave the Commission "the authority to 'execute and enforce,'" and "to 'prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions' of," the Communications Act of 1934. 545 U.S., at 980–981 . . . (quoting 47 U.S.C. §§ 151, 201(b)). . . .

We believe *Chevron* and *Mead*, rather than *National Muffler* and *Rowan*, provide the appropriate framework for evaluating the full-time employee rule. The Department issued the full-time employee rule pursuant to the explicit authorization to "prescribe all needful rules and regulations for the enforcement" of the Internal Revenue Code. 26 U.S.C. § 7805(a). We have found such "express congressional authorizations to engage in the process of rulemaking" to be "a very good indicator of delegation meriting *Chevron* treatment." *Mead, supra*, at 229 . . . . The Department issued the full-time employee rule only after notice-and-comment procedures, 69 Fed. Reg. 76405, again a consideration identified in our precedents as a "significant" sign that a rule merits *Chevron* deference. *Mead*, *supra*, at 230–231 . . . .

> We have explained that "the ultimate question is whether Congress would have intended, and expected, courts to treat [the regulation] as within, or outside, its delegation to the agency of 'gap-filling' authority." *Id.* at 173 . . . (emphasis deleted). . . . These same considerations point to the same result here. This case falls squarely within the bounds of, and is properly analyzed under, *Chevron* and *Mead*.

Mayo, 562 U.S. at 53–58 (citations omitted).[3] The Court ultimately concluded that the Treasury's regulation, which based the determination of whether medical residents were subject to payroll tax on whether they worked more than 40 hours per week, was a reasonable interpretation of the statute. *Id*. at 58.

The *Mayo* decision has received a lot of attention from the academic and practitioner communities. For further analysis of the decision and some potential implications of the holding, see, *e.g.*, Steve R. Johnson, *Preserving Fairness in Tax Administration in the* Mayo *Era*, 32 VA. TAX REV. 269 (2012) (arguing that *Mayo* provides benefits for tax administration but risks altering the balance between taxpayers and the government, especially in combination with other doctrines, such as *Seminole Rock* and *Brand X* deference, and exploring how to remedy that); Steve R. Johnson, Mayo *and the Future of Tax Regulations*, 130 TAX NOTES 1547 (2011); Leandra Lederman, *The Fight Over "Fighting Regs" and Judicial Deference in Tax Litigation*, 92 B.U. L. REV. 643 (2012); Leandra Lederman & Stephen W. Mazza, *More Mayo Please? Temporary Regulations After* Mayo Foundation v. United States, 31 A.B.A. SEC. OF TAX'N NEWSQUARTERLY 15 (2011); Irving Salem, Mayo *Dissected: Some Dragons Slain, Some Still Breathing Fire*, 130 TAX NOTES 1327 (2011); Patrick J. Smith, *Challenges to Tax Regulations: The APA and the Anti-Injunction Act*, 147 TAX NOTES 915 (2015); Patrick J. Smith, *Life After* Mayo*: Silver Linings*, 131 TAX NOTES 1251 (2011); Tomas D. Sykes, *The "*Mayo*" Decision's Problematic Tax Analysis*, DAILY TAX REP. (BNA), Mar. 22, 2011, at J-1.

For discussion of courts' application of *Chevron* to uphold (or in the case of the Tax Court, invalidate) Treasury regulations that imposed a two-year statute of limitations on requesting equitable innocent spouse relief under Code section 6015(f), see Section 17.02[B][1] of this Supplement. *Cf.* Patrick J. Smith, Chevron*'s Conflict with the Administrative Procedure Act*, 32 VA. TAX REV. 813, 814 (2013) (arguing that "By permitting agencies, under step two of

[3] The U.S. Supreme Court subsequently applied *Rowan* to uphold its "major principle . . . : that simplicity of administration and consistency of statutory interpretation instruct that the meaning of 'wages' should be in general the same for income-tax withholding and for FICA calculations." United States v. Quality Stores, Inc., 134 S. Ct. 1395, 1405 (2014). In that case, the Court ruled for the IRS, holding that certain severance payments constituted "wages" for FICA purposes. *Id.* Although tax professor Kristin Hickman filed an amicus brief in *Quality Stores* arguing that the case implicated a judicial deference issue not raised by the parties—-the level of deference accorded Revenue Rulings—the Court did not address that issue. *See id.* ("[T]he Court notes that the IRS still provides that severance payments tied to the receipt of state unemployment benefits are exempt not only from income-tax withholding but also from FICA taxation. *See, e.g.*, Rev. Rul. 90-72, 1990-2 Cum. Bull. 211. Those Revenue Rulings are not at issue here."); *see also Law Professor Files Amicus Brief with Supreme Court in Quality Stores*, 2013 TAX NOTES TODAY 224-17 (Nov. 20, 2013).

Chevron's two-part test, to adopt interpretations of statutory provisions that a court reviewing the agency's interpretation is required to accept, even if the reviewing court concludes the agency's interpretation is not the best reading of the statutory provision, *Chevron* is in direct and irreconcilable conflict with this APA requirement that 'the reviewing court shall . . . interpret . . . statutory provisions.'").

In May 2013, the U.S. Supreme Court decided *City of Arlington v. FCC*, 133 S. Ct. 1863 (2013), a non-tax judicial deference case. Justice Scalia delivered the opinion of the Court, which framed the issue as follows: "[W]hether an agency's interpretation of a statutory ambiguity that concerns the scope of its regulatory authority (that is, its jurisdiction) is entitled to deference under *Chevron* . . . ." *Id.* at 1866 (citation omitted). The Court held that such jurisdictional interpretations are entitled to deference, explaining in part:

> The argument against deference rests on the premise that there exist two distinct classes of agency interpretations: Some interpretations—the big, important ones, presumably—define the agency's "jurisdiction." Others—humdrum, run-of-the-mill stuff—are simply applications of jurisdiction the agency plainly has. That premise is false, because the distinction between "jurisdictional" and "nonjurisdictional" interpretations is a mirage. No matter how it is framed, the question a court faces when confronted with an agency's interpretation of a statute it administers is always, simply, *whether the agency has stayed within the bounds of its statutory authority*.

Id. at 1868 (emphasis in original). For a helpful explication of this standard, see the Seventh Circuit opinion in *Zivkovic v. Holder*, 724 F.3d 894, 899 (2013) ("*Arlington* reaffirms the general principle that a court must defer to an agency's reasonable interpretation of the scope of its own authority, regardless of whether that issue concerns the agency's jurisdiction or any other interpretation of its enabling statute. . . . Nothing in *Arlington* instructs courts to skip the first step of the *Chevron* process—that is, the assessment whether there is any ambiguity to be addressed after applying the ordinary tools of statutory construction.") (citation omitted). *See also* Thomas W. Merrill, *Step Zero After* City of Arlington, 83 FORDHAM L. REV. 753, 757 (2014) (arguing in part that "Chief Justice Roberts's suggestion that a more carefully calibrated application of the *Mead* factors could serve as a substitute for an explicit 'agency jurisdiction' inquiry as part of Step Zero . . . represents the best available solution to reconciling *Chevron* with the courts' traditional boundary maintenance function."); Patrick J. Smith, Chevron *Step Zero After* City of Arlington, 140 TAX NOTES 713, 718 (2013) (arguing that "Scalia's majority opinion suggests that the multifactor analysis aspect of *Mead*'s *Chevron* step zero test has no vitality.").

In *City of Arlington*, Justice Breyer concurred in part and in the judgment. Chief Justice Roberts dissented, joined by Justices Kennedy and Alito. The dissent begins as follows:

> My disagreement with the Court is fundamental. It is also easily expressed: A court should not defer to an agency until the court decides, on its

> own, that the agency is entitled to deference. Courts defer to an agency's interpretation of law when and because Congress has conferred on the agency interpretive authority over the question at issue. An agency cannot exercise interpretive authority until it has it; the question whether an agency enjoys that authority must be decided by a court, without deference to the agency.

133 S. Ct. at 1877 (Roberts, C.J., dissenting).

In *Exelon Wind 1, L.L.C. v. Nelson*, 766 F.3d 380, 392 (2014), the Fifth Circuit distinguished *City of Arlington*, explaining that *City of Arlington* addressed the question of whether a court should apply *Chevron* to an agency's determination of its own jurisdiction. By contrast, the issue in *Exelon Wind* was whether Exelon's "claims belong in a state or a federal court." *Id.* The Fifth Circuit stated, "*City of Arlington* does not address this entirely different proposition advocated by Exelon, and does not support the argument that we should defer to the FERC's [Federal Energy Regulatory Council] interpretation of our own jurisdiction under the statutory scheme." In addition to citing its own precedent, the Fifth Circuit relied in part on *Shweika v. Dep't of Homeland Sec.*, 723 F.3d 710, 719 (6th Cir. 2013) for the proposition that an agency's interpretation of a court's subject-matter jurisdiction is not entitled to deference. *Exelon Wind 1*, 766 F.3d at 392. To the same effect, see B & H Medicine, L.L.C. v. United States, 116 Fed. Cl. 671, 680 n.1 (Ct. Cl. 2014) (citing *City of Arlington* for the proposition that "[t]he Supreme Court has concluded that *Chevron* deference applies to an agency's interpretation of its *own* jurisdiction, making clear, however, that agency jurisdiction and federal court jurisdiction are distinct concepts") (emphasis in original).

By contrast, in 2015, the Court of Appeals for the Tenth Circuit refused to narrow the scope of *City of Arlington*. In *WildEarth Guardians v. U.S. Fish and Wildlife Serv.*, 784 F.3d 677, 683 (10th Cir. 2015), the appellants argued that *Chevron* should not apply to agency actions taken pursuant to statutes that regulate the agency itself, as opposed to contexts in which Congress has "delegate[d] administration" to the agency. The court stated that *City of Arlington* did not draw

> any distinction between statutes that "regulate" an agency and those that are "administered" by one. Indeed, it would be odd if the law did draw such a distinction, as any statute that an agency administers necessarily regulates that agency to some extent, at least in the sense that it imposes various obligations on the agency and instructs it to take various actions.

WildEarth Guardians, 784 F.3d at 683 (footnote omitted). Accordingly, the Tenth Circuit granted *Chevron* deference to the agency interpretation at issue. *Id.*

This discussion has focused on deference to agencies. The U.S. Tax Court at one time was an independent agency within the executive branch, a fact that sometimes implicates deference issues. For a discussion of the history of deference given to the Tax Court on appeal, see Leandra Lederman, *(Un)Appealing Deference to the Tax Court*, 63 DUKE L.J. 1835 (2014) (analyzing the history of the *Dobson* rule and its shortcomings and arguing that Tax Court decisions should not be subject to special deference).

§ 2.02[A][2][b] (If *Chevron* Applies, Then How?)

Whether a court should take legislative history into account in performing the first step of *Chevron* analysis remains unclear. *See* Jeffrey N. Starkey & Thomas A. Cullinan, *Is the IRS Always Right? Judicial Deference to Treasury Regulations and Other IRS Positions*, J. TAX. PRAC. & PROC., Aug.-Sep. 2012, at 31, 32. Although the Supreme Court in *Mayo* had the opportunity to address the role of legislative history, which was discussed in both parties' briefs, the Court declined to do so and focused, instead, "exclusively on the terms of the statute in question." *Id.*; *see also* Mayo, 562 U.S. at 52–53.

Recently, at least one scholar has questioned the role of legislative history in both step one and step two of the *Chevron* two-step process. *See* Seth Davis, *The Chevron Shuffle and Legislative History*, PRAWFSBLAWG (June 16, 2015, 5:51 PM), http://prawfsblawg.blogs.com/prawfsblawg/2015/06/the-chevron-shuffle-and-legislative-history.html (discussing the D.C. Circuit's opinion in *Council for Urological Interests v. Burwell*, and explaining that the court "shuffled between one view and another of legislative history's role in the Chevron analysis."). This issue also arose in the Fourth Circuit's decision in *King v. Burwell*, 759 F.3d 358 (2014), which raised the question of whether a provision in the Affordable Care Act (ACA) referring to "an Exchange established by the State" was ambiguous for purposes of step one of *Chevron*. Interestingly, the Fourth Circuit examined the "plain language and context of the most relevant statutory sections, the context and structure of related provisions, and the *legislative history* of the Act," in order to arrive at the conclusion that the ACA is ambiguous on this point, thus moving to step two of the Chevron analysis. *See id.* at 372 (emphasis added). The court concluded that the IRS's final rule extending tax credits to individuals who had purchased health insurance on a federally-facilitated insurance exchange (as opposed to one established by a State) rested on a permissible construction of the ACA. *Id.* at 363.

In June 2015, the U.S. Supreme Court decided the case, affirming the Fourth Circuit. King v. Burwell, No. 14-114, 2015 U.S. LEXIS 4248 (Jun. 25, 2015). The Supreme Court's decision focused on the "step zero" aspect of the doctrine. The Court stated that this was an extraordinary type of case:

> The tax credits are among the Act's key reforms, involving billions of dollars in spending each year and affecting the price of health insurance for millions of people. Whether those credits are available on Federal Exchanges is thus a question of deep "economic and political significance" that is central to this statutory scheme; had Congress wished to assign that question to an agency, it surely would have done so expressly. *Utility Air Regulatory Group v. EPA*, 134

> S. Ct. 2427, 2444 . . . (2014) (quoting Brown & Williamson, 529 U. S., at 160). It is especially unlikely that Congress would have delegated this decision to the IRS, which has no expertise in crafting health insurance policy of this sort. *See Gonzales v. Oregon*, 546 U. S. 243, 266-267 . . . (2006). This is not a case for the IRS.

Burwell, 2015 U.S. LEXIS 4248, at *18–19. The Court proceeded with its own searching *de novo* review of the ACA's interlocking provisions and concluded that "an Exchange established by the State," while ambiguous, was correctly interpreted by the IRS to include federal exchanges, consistent with Congressional intent. *Id.* at *37.

§ 2.02[A][2][d] (What About Temporary and Proposed Regulations?)

Case law addressing the question of whether a taxpayer's overstatement of basis in disposed-of property formerly used in a trade or business constitutes a "substantial omission of items" for purposes of the six-year statute of limitations under Code section 6501(e) raises some interesting questions about the IRS's authority to issue regulations that are contrary to established judicial precedent.[4] As explained below, in connection with Section 7.03[C][2], the government argued in several cases involving tax shelter transactions that an overstatement of basis can result in a substantial omission of items, thereby extending the statute of limitations on assessment to six years. The government lost on this issue in 2009 in *Salman Ranch Ltd. v. United States*, 573 F.3d 1362 (Fed. Cir. 2009) and in *Bakersfield Energy Partners v. Commissioner*, 568 F.3d 767 (9th Cir. 2009).

In *Bakersfield Energy*, the Ninth Circuit concluded:

> However sensible the IRS's argument may be that a taxpayer can "omit . . . an amount" of gain by overstating its basis, this argument is foreclosed by *Colony*[*, Inc. v. Comm'r*, 357 U.S. 28 (1958)]. The Court acknowledged that the statutory language was ambiguous, 357 U.S. at 33 . . . but nonetheless rejected the same interpretation the IRS is proposing in this case. The IRS may have the authority to promulgate a reasonable reinterpretation of an ambiguous provision of the tax code, even if its interpretation runs contrary to the Supreme Court's "opinion as to the best reading" of the provision. *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs*., 545 U.S. 967, 982–83 . . . (2005); *accord Swallows Holding, Ltd. v. Comm'r*, 515 F.3d 162, 170 (3d Cir. 2008). We do not.

568 F.3d at 778.

Perhaps accepting this invitation, on September 24, 2009, the Treasury Department issued proposed and temporary regulations, maintaining the government's position both with respect to the general six-year period and with respect to partnership items. *See* Joseph

[4] Students unfamiliar with the underlying statute of limitations question may benefit from reading the discussion in Section 7.03[C][2] in the text and Supplement.

DiSciullo, *Proposed Regulations Define Omission from Gross Income*, 125 TAX NOTES 75 (2009). Some commentators have referred to these regulations as "fighting regs." *See generally* Leandra Lederman, *The Fight Over "Fighting Regs" and Judicial Deference in Tax Litigation*, 92 B.U. L. REV. 643 (2012). The Treasury Department finalized the proposed section 6501 regulations in December of 2010. *See* T.D. 9511, 2011-06 I.R.B. 455. The regulations provide in part that "an understated amount of gross income resulting from an overstatement of unrecovered cost or other basis constitutes an omission from gross income for purposes of section 6501(e)(1)(A)(i) [or section 6229(c)(2)]." Treas. Reg. § 301.6501(e)-1(a)(1)(iii); Treas. Reg. § 301.6229(c)(2)-1(a)(1)(iii). One private practitioner explains:

> In the preamble to the regulations, Treasury rehashed one of its arguments —namely that at the time section 6501(e)(1)(A)(i) was promulgated, Congress was fully aware of the dispute in the courts concerning whether overstated basis constituted an omission from gross income and thus added the trade or business provision to resolve the issue outside the context of a trade or business case (that is, to make overstatement of basis an omission in that non-trade-or-business context). Thus, according to Treasury, the new regulations merely clarify the government's long-standing interpretation of section 6501(e)(1)(A)(i)—which Treasury believes was interpreted by the courts as ambiguous—and limit the holding in *Colony* to the trade or business context. . . .
>
> The preamble focuses on several of the recent cases addressing the overstatement of tax basis in applying the six-year statute of limitations, including the alleged son-of-BOSS cases, and notes Treasury's disagreement over the taxpayer-favorable decisions.

Mark Allison, *The New Battle in an Old War: Omissions from Gross Income*, 126 TAX NOTES 1227, 1239 (2010).

A particular sticking point for taxpayers was that the effective date of the regulations was "taxable years with respect to which the applicable period for assessing tax did not expire before September 24, 2009."[5] *See, e.g.*, Temp. Treas. Reg. § 301.6501(e)-1T(b) (2009). The government argued that whether the statute of limitations on assessment was open on the date was to be determined under those regulations, as discussed below. Moreover, after the regulations were promulgated, the government filed motions to vacate prior opinions in which courts had held that understatements of income resulting from overstatements of basis did not constitute omissions of items, and to reconsider those prior opinions in light of the newly promulgated temporary regulations. *See* Allison, *supra*, at 1240 ("[F]ollowing the issuance of the regulations, Justice moved for the Federal Circuit to reconsider its decision in *Salman Ranch*

[5] The final regulations changed the language slightly, to "Paragraph (a) of this section applies to taxable years with respect to which the period for assessing tax was open on or after September 24, 2009." Treas. Reg. § 301.6501(e)-1(e)(1).

based on the new guidance, confirming the obvious goal of the regulations. (The motion was denied, and the reconsideration period in *Bakersfield Energy* had already closed.)").

In *Intermountain Insurance Service of Vail, LLC v. Commissioner*, T.C. Memo. 2009-195, a case involving a partnership return filed on September 15, 2000 and a partnership administrative adjustment (FPAA) sent on September 14, 2006, the Tax Court followed its decision in *Bakersfield Energy*, cited on page 266 of the text, to the effect that overstated basis does not give rise to an omission of income for purposes of section 6501(e)(1). After the temporary and proposed regulations were issued, the government moved for reconsideration of *Intermountain*, as well.[6] *See* Intermountain Ins. Serv. of Vail, LLC v. Comm'r, 134 T.C. 211 (2010) (reviewed by the court), *rev'd and remanded*, 650 F.3d 691 (D.C. Cir. 2011), *vacated and remanded*, 132 S. Ct. 1836 (2012).[7] *Id.*

In *Intermountain*, the Tax Court reaffirmed its holding in its earlier opinion in the case to the effect that "the general 3-year limitations period of section 6501(a) was the applicable period for assessing tax in this case and that it had expired some time before September 14, 2006." *Id.* at 218. This was also consistent with the Tax Court's holding in *Bakersfield Energy Partners*, 128 T.C. 207 (2007), which had been affirmed by the Court of Appeals for the Ninth Circuit in the decision cited above. *Intermountain*, 134 T.C. at 218–19. The court also rejected the IRS's rather circular argument that "'The temporary regulations apply to petitioner's 1999 tax year, because the period of limitations under sections 6229(c)(2) and 6501(e)(1)(A), as interpretated [sic] in the regulations, remains open with respect to that year.'" *Id.* at 219 (quoting the IRS's motion to reconsider). The IRS's argument thus attempted to use its own regulations to assert that they apply to a case in which the statute would otherwise have expired. This arguably raises an issue of retroactivity. *See* Robert Horwitz & Courtney Hopley, *California Bar Recommends Narrower Potential Remedies for Statute of Limitations Issues*, 2010 TAX NOTES TODAY 117-49 (June 18, 2010) ("[T]he temporary regulations have potential retroactive effect in cases where the three-year period for assessment has closed, but the six-year period remains open.").

After finding that the temporary regulations did not apply because of their effective date provision, the Tax Court then considered whether the regulations would be entitled to judicial deference if they were applicable. *See Intermountain*, 134 T.C. at 220. It did not reach the question of what level of deference to apply because, applying the test set forth in *Brand X* (discussed in the text starting on page 44), it found the regulations invalid in light of *Colony*. *See id.* at 223–24. Specifically, the majority held that in *Colony*, the Supreme Court found that the extended statute of limitations would only apply "'where a taxpayer actually omitted some income receipt or accrual in his computation of gross income, and not more generally to errors in

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[6] The government's motion was late but the Tax Court allowed it. *Intermountain*, 134 T.C. at 215.
[7] The U.S. Supreme Court eventually vacated the judgment of the Court of Appeals for the District of Columbia Circuit in the case (which had reversed the Tax Court) and remanded for reconsideration in light of *United States v. Home Concrete & Supply, L.L.C.*, 132 S. Ct. 1836 (2012), discussed below. Intermountain Ins. Serv. of Vail, LLC v. Comm'r, 132 S. Ct. 2120 (2012) (mem.). Ultimately, the D.C. Circuit dismissed the case on the IRS's unopposed motion.
No. 10-1204, 2012 U.S. App. LEXIS 11811 (D.C. Cir. June 11, 2012) (per curiam).

that computation arising from other causes.'" *Id.* at 224 (citing *Colony*, 357 U.S. at 33). According to the Tax Court, the Supreme Court's opinion thus "'unambiguously foreclose[d] the agency's interpretation' of sections 6229(c)(2) and 6501(e)(1)(A) and displaces respondent's temporary regulations." *Id.* (citing *Brand X*, 545 U.S. at 983).

As noted below in Chapter 7 of this Supplement, the government continued to litigate the statute of limitations issue, which resulted in a circuit split. Both the Fourth and Fifth Circuits declined to apply the regulations interpreting the extended statute of limitations for omissions from gross income. *See* Home Concrete & Supply, LLC v. United States, 634 F.3d 249 (4th Cir. 2011), *aff'd*, 132 S. Ct. 1836 (2012); Burks v. United States, 633 F.3d 347 (5th Cir. 2011). Both courts found that Code section 6501(e)(1) was unambiguous in light of the Supreme Court's decision in *Colony*, so the regulations failed step one of the *Chevron* analysis. *See Home Concrete*, 634 F.3d at 257; *Burks*, 633 F.3d at 360. The Fifth Circuit raised some additional concerns in a footnote:

> Although we hold that § 6501(e)(1)(A) is unambiguous and its meaning is controlled by the Supreme Court's decision in *Colony*, we note that even if the statute was ambiguous and *Colony* was inapplicable, it is unclear whether the Regulations would be entitled to *Chevron* deference under *Mayo Foundation for Medical Research v. United States*, 131 S. Ct. 704, 711 . . . (2011). . . . In *Mayo*, the Court held that the principles underlying its decision in *Chevron* "apply with full force in the tax context" and applied *Chevron* to treasury regulations issued pursuant to 26 U.S.C. § 7805(a). *Id.* at 707. Significantly, in *Mayo* the Supreme Court was not faced with a situation where, during the pendency of the suit, the treasury promulgated determinative, retroactive regulations following prior adverse judicial decisions on the identical legal issue. "Deference to what appears to be nothing more than an agency's convenient litigating position" is "entirely inappropriate." *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 213 . . . (1988). The Commissioner "may not take advantage of his power to promulgate retroactive regulations during the course of a litigation for the purpose of providing himself with a defense based on the presumption of validity accorded to such regulations." *Chock Full O' Nuts Corp. v. United States*, 453 F.2d 300, 303 (2d Cir. 1971).
>
> Moreover, *Mayo* emphasized that the regulations at issue had been promulgated following notice and comment procedures, "a consideration identified . . . as a significant sign that a rule merits *Chevron* deference." [*Mayo*,] 131 S. Ct. at 714. Legislative regulations are generally subject to notice and comment procedure pursuant to the Administrative Procedure Act. *See* 5 U.S.C. § 553(b)(A). Here, the government issued the Temporary Regulations without subjecting them to notice and comment procedures. This is a practice that the Treasury apparently employs regularly. . . . That the government allowed for

notice and comment after the final Regulations were enacted is not an acceptable substitute for pre-promulgation notice and comment. *See U.S. Steel Corp. v. U.S. EPA*, 595 F.2d 207, 214–15 (5th Cir. 1979).

Burks, 633 F.3d at 360 n.9.

A month later, the Court of Appeals for the Federal Circuit disagreed with the Fourth and Fifth Circuits on the same issue. Grapevine Imports, Ltd. v. United States, 636 F.3d 1368 (Fed. Cir. 2011), *vacated and remanded*, 132 S. Ct. 2099 (2012).[8] The Federal Circuit found Code section 6501(e)(1) to be ambiguous and, applying *Chevron* to the final regulations, ruled that the regulations represented a reasonable interpretation of the statute. *Id*. at 1378–79. The court concluded that an overstatement of basis does constitute an omission from gross income and therefore extends the limitations period to six years. *Id.* at 1384. The court also rejected the taxpayer's argument that, because the regulations were first issued in temporary form without notice and comment, they were entitled to a lower degree of deference. *Id.* at 1380 –81. The court explained that it was applying the final, rather than temporary, version of the regulations. Finally, in response to the taxpayer's argument that the regulations should not be applied retroactively, the court cited Code section 7805(b) and concluded that retroactive application was not an abuse of discretion on the IRS's part. *Id*. at 1381–82.[9]

The Supreme Court granted certiorari in *Home Concrete* and affirmed the Fourth Circuit. United States v. Home Concrete & Supply, LLC, 132 S. Ct. 1836 (2012). In a divided opinion, the Court ruled that because the statutory language at issue in *Home Concrete* was the same language at issue in *Colony*, the result—a three rather than six-year statute of limitations—should apply. *Id.* at 1839. Because the Court found that *Colony* left no room for a different interpretation of the statute by the Treasury, it found the Treasury regulations invalid. *See id.* at 1842–43. It therefore did not need to address the issue, mentioned during the oral argument, of whether *Brand X* (which, as explained in the text, would allow an administrative agency to overturn a prior court decision) would allow a regulation to overturn a Supreme Court decision that had found the statute ambiguous. *See* Transcript of Oral Argument at 55, *Home Concrete*, 132 S. Ct. 1836 (No. 11-139), *available at* http://www.supremecourt.gov/oral_arguments/argument_transcripts/11-139.pdf.

Nonetheless, Justice Breyer, writing for a plurality of four Justices, countered the IRS's contention that *Brand X* allowed the government to overturn the Court's earlier opinion in *Colony*:

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[8] The Court of Appeals for the District of Columbia Circuit had sided with the Federal Circuit on this issue. *Intermountain Ins. Serv. of Vail, LLC v. Comm'r*, 650 F.3d at 707 (D.C. Cir. 2011), *vacated and remanded*, 132 S. Ct. 1386 (2012).

[9] For further discussion of retroactivity and how it has evolved, as well as possible conflicts with Congressional intent, see John Bunge, *Statutory Protection From IRS Reinterpretation of Old Tax Laws*, 144 TAX NOTES 1177, 1185 (2014).

The fatal flaw in the Government's contrary argument is that it overlooks the reason why *Brand X* held that a "prior judicial construction," unless reflecting an "unambiguous" statute, does not trump a different agency construction of that statute. 545 U.S., at 982 . . . . The Court reveals that reason when it points out that "it is for agencies, not courts, to fill statutory gaps." *Ibid.* The fact that a statute is unambiguous means that there is "no gap for the agency to fill" and thus "no room for agency discretion." *Id.,* at 982–983 . . . .

In so stating, the Court sought to encapsulate what earlier opinions, including *Chevron*, made clear. Those opinions identify the underlying interpretive problem as that of deciding whether, or when, a particular statute in effect delegates to an agency the power to fill a gap, thereby implicitly taking from a court the power to void a reasonable gap-filling interpretation. Thus, in *Chevron* the Court said that, when

> Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation. . . . Sometimes the legislative delegation to an agency on a particular question is implicit rather than explicit. [But in either instance], a court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of an agency. 467 U.S., at 843–844 . . . .

See also United States v. *Mead Corp.*, 533 U.S. 218, 229 . . . (2001) . . . .

Chevron and later cases find in unambiguous language a clear sign that Congress did *not* delegate gap-filling authority to an agency; and they find in ambiguous language at least a presumptive indication that Congress did delegate that gap-filling authority. Thus, in *Chevron* the Court wrote that a statute's silence or ambiguity as to a particular issue means that Congress has not "directly addressed the precise question at issue" (thus likely delegating gap-filling power to the agency). 467 U.S., at 843 . . . . In *Mead* the Court, describing *Chevron*, explained:

> Congress . . . may not have expressly delegated authority or responsibility to implement a particular provision or fill a particular gap. Yet it can still be apparent from the agency's generally conferred authority and other statutory circumstances that Congress would expect the agency to be able to speak with the force of law when it addresses ambiguity in the statute or fills a space in the enacted law, even one about which Congress did not

> actually have an intent as to a particular result. 533 U.S., at 229 . . . (internal quotation marks omitted).

Chevron added that "[i]f a court, *employing traditional tools of statutory construction,* ascertains that Congress had an intention on the precise question at issue, that intention is the law and must be given effect." 467 U.S., at 843, n. 9 . . . (emphasis added).

As the Government points out, the Court in *Colony* stated that the statutory language at issue is not "unambiguous." 357 U.S., at 33, ... But the Court decided that case nearly 30 years before it decided *Chevron.* There is no reason to believe that the linguistic ambiguity noted by *Colony* reflects a post-*Chevron* conclusion that Congress had delegated gap-filling power to the agency. At the same time, there is every reason to believe that the Court thought that Congress had "directly spoken to the question at hand, and thus left "[no] gap for the agency to fill." *Chevron, supra,* at 842–843 . . . .

For one thing, the Court said that the taxpayer had the better side of the textual argument. *Colony,* 357 U.S., at 33 . . . . For another, its examination of legislative history led it to believe that Congress had decided the question definitively, leaving no room for the agency to reach a contrary result. It found in that history "persuasive indications" that Congress intended overstatements of basis to fall outside the statute's scope, and it said that it was satisfied that Congress "intended an exception . . . only in the restricted type of situation" it had already described. *Id.,* at 35–36 . . . . Further, it thought that the Commissioner's interpretation (the interpretation once again advanced here) would "create a patent incongruity in the tax law." *Id.,* at 36–37 . . . . And it reached this conclusion despite the fact that, in the years leading up to *Colony*, the Commissioner had consistently advocated the opposite in the circuit courts. . . . Thus, the Court was aware it was rejecting the expert opinion of the Commissioner of Internal Revenue. And finally, after completing its analysis, *Colony* found its interpretation of the 1939 Code "in harmony with the [now] unambiguous language" of the 1954 Code, which at a minimum suggests that the Court saw nothing in the 1954 Code as inconsistent with its conclusion. 357 U.S., at 37 . . . .

It may be that judges today would use other methods to determine whether Congress left a gap to fill. But that is beside the point. The question is whether the Court in *Colony* concluded that the statute left such a gap. And, in our view, the opinion (written by Justice Harlan for the Court) makes clear that it did not.

Given principles of *stare decisis*, we must follow that interpretation. And there being no gap to fill, the Government's gap-filling regulation cannot change *Colony*'s interpretation of the statute. We agree with the taxpayer that

> overstatements of basis, and the resulting understatement of gross income, do not trigger the extended limitations period of § 6501(e)(1)(A). The Court of Appeals reached the same conclusion. See 634 F.3d 249 (CA4 2011). And its judgment is affirmed.

Home Concrete, 132 S. Ct. at 1843–44 (plurality opinion).

This may be one of the most interesting parts of the opinion. However, Justice Scalia, who joined four other justices to form a majority in *Home Concrete* but who had dissented in Brand X, did not join the portion of the opinion quoted above. He filed a separate concurrence citing his dissent in *Brand X* and arguing that that case should be overturned. *See id.* at 1846–49 (Scalia, J., concurring). He also accused Justice Breyer of distorting *Brand X*:

> [I]n order to evade *Brand X* and yet reaffirm *Colony*, the plurality would add yet another lop-sided story to the ugly and improbable structure that our law of administrative review has become: To trigger the *Brand X* power of an authorized "gap-filling" agency to give content to an ambiguous text, a pre-*Chevron* determination that language is ambiguous does not alone suffice; the pre-*Chevron* Court must in addition have found that Congress wanted *the particular ambiguity in question* to be resolved by the agency.

Id. at 1847 (Scalia, J., concurring in part and concurring in the judgment).

Justice Kennedy dissented, joined by Justices Ginsburg, Sotomayor, and Kagan. *See id.* at 1849–53 (Kennedy, J., dissenting). They argued in part:

> If the Government is to prevail in the instant case the regulation in question must be a proper implementation of the same language the Court considered in *Colony*; but the statutory interpretation issue here cannot be resolved, and the *Colony* decision cannot be deemed controlling, without first considering the inferences that should be drawn from added statutory text. The additional language was not part of the statute that governed the taxpayer's liability in *Colony*, and the Court did not consider it in that case. Congress revised the Internal Revenue Code in 1954, several years before *Colony* was decided but after the tax years in question in that case. Although the interpretation adopted by the Court in *Colony* can be a proper beginning point for the interpretation of the revised statute, it ought not to be the end.

Id. at 1850. The dissent concluded:

> Under the circumstances, the Treasury Department had authority to adopt its reasonable interpretation of the new tax provision at issue. *See Mayo Foundation for Medical Ed. and Research* v. *United States*, 562 U.S. __, __, 131 S. Ct. 704 . . . (2011) (slip op., at 10). This was also the conclusion reached in

> well-reasoned opinions issued in several cases before the Courts of Appeals. *E.g., Intermountain*, 650 F. 3d, at 705–706 (reaching this conclusion "because the Court in *Colony* never purported to interpret [the new provision]; because [the new provision]'s 'omits from gross income' text is at least ambiguous, if not best read to include overstatements of basis; and because neither the section's structure nor its [history and context] removes this ambiguity").
>
> The Department's clarification of an ambiguous statute, applicable to these taxpayers, did not upset legitimate settled expectations. Given the statutory changes described above, taxpayers had reason to question whether *Colony*'s holding extended to the revised § 6501(e)(1). See*, e.g., CC & F Western Operations L. P.* v. *Commissioner,* 273 F.3d 402, 406, n. 2 (C.A.1 2001) ("Whether *Colony*'s main holding carries over to section 6501(e)(1) is at least doubtful"). Having worked no change in the law, and instead having interpreted a statutory provision without an established meaning, the Department's regulation does not have an impermissible retroactive effect. Cf. *Smiley* v. *Citibank (South Dakota), N. A.*, 517 U.S. 735, 741, 744, n. 3 . . . (1996) (rejecting retroactivity argument); *Manhattan Gen. Equipment Co.* v. *Commissioner*, 297 U.S. 129, 135 . . . (1936) (same). It controls in this case.

Id. at 1852–54 (alterations in original).

The fractured *Home Concrete* opinion "creates considerable uncertainty regarding the standards governing Treasury Regulations when they run contrary to judicial precedent." Richard M. Lipton & Russell R. Young; *Supreme Court's Decision in* Home Concrete *Reveals Cracks in the Foundation of* Brand X, 117 J. TAX'N. 4, 9 (2012). In other words, how is the Court's reliance on *Colony* consistent with *Brand X*?

> Is it because *Colony* was decided prior to *Chevron*? Is it because *Colony* was decided prior to *Brand X*? Is it because *Brand X* does not apply to decisions of the Supreme Court? Or is it because, despite significant evidence to the contrary, *Colony* was actually interpreting an unambiguous statute? None of these questions is answered by the majority opinion and the plurality opinion would only cast a little light on the issues even if it had precedential effect.

Id.

In addition, *Home Concrete's* narrow holding, which did not address the APA claims raised in the lower court, leaves an open question regarding the extent to which administrative law principles apply to tax regulations. Jeremiah Coder, *Use of Legislative History Uncertain After* Home Concrete, *Officials Say*, 135 TAX NOTES 1565, 1566 (2012). A case subsequent to *Home Concrete*, *Dominion Resources, Inc. v. United States*, 681 F.3d 1313 (Fed. Cir. 2012), invoked the APA's arbitrary and capricious standard and held that "a provision in the interest capitalization regulations under section 263A was invalid under the arbitrary and capricious standard, because the IRS had failed to explain in the preamble to the regulations the reasons for adopting the rule that was at issue." Patrick J. Smith, *The APA's Arbitrary and Capricious Standard and IRS Regulations*, 136 TAX NOTES 271, 273 (2012).[10]

It is unclear how the IRS will respond to *Dominion Resources. Compare* Shamik Trivedi, *Administrative Law Front and Center After* Dominion Resources, 135 TAX NOTES 1308, 1309 (2012) (quoting Carlton M. Smith, director of the Benjamin N. Cardozo School of Law Tax Clinic, as stating, "Treasury may have to change its practices in preambles to avoid invalidated regs[.]") *with* Coder, *supra*, at 1566 (quoting Henry Schneiderman, special counsel, IRS Office of Associate Chief Counsel (Procedure and Administration), as stating that "[t]he IRS 'does a pretty good job of explaining the purpose of our action and what we're doing [and] why we're doing it in our preamble' to regulations." (alteration in original)). However, a Treasury attorney made a somewhat different statement at a 2013 ABA Tax Section meeting. *See* Jeremiah Coder, *ABA Section of Taxation Meeting: Treasury Views Most Regs As Outside Notice and Comment Rules*, 139 TAX NOTES 884 (2013) (reporting that "'[m]ost of the rules that we issue are not legislative regulations' and thus don't require an extensive explanation in the reg preamble, Alexandra Minkovich, attorney-adviser, Treasury Office of Tax Legislative Counsel, said during a Court Procedure and Practice session of the American Bar Association Section of Taxation meeting in Washington.").

For an argument that the IRS should not only satisfy the APA notice-and-comment procedures, but also affirmatively solicit input from taxpayers, consumer groups, and other experts "when confronted with the need to formulate rules that are likely to impact the lives of disadvantaged or low-income taxpayers, . . ." because standard notice-and-comment procedures may be insufficient to truly provide notice of the rules to such taxpayers, see Leslie Book, *A New Paradigm for IRS Guidance: Ensuring Input and Enhancing Participation*, 12 FLA. TAX REV. 517, 530 (2012). For an argument for proactive "collaborative tax regulation," see Danshera Cords, *"Let's Get Together": Collaborative Tax Regulation*, 11 PITT. TAX REV. 49, 53 (2013) (explaining her idea that "Treasury would identify the need for a new rule, consider the appropriateness of the project for collaboration, and, if appropriate, identify and invite into the process the major stakeholders. This participation would begin . . . before the rule was developed into a proposed rule.").

For further analysis of the Supreme Court's *Home Concrete* opinion, see Steve R. Johnson, *Reflections on* Home Concrete*: Writing Tax Regulations and Interpreting Tax Statutes*,

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[10] For discussion of the possible use of the APA's "reasoned-explanation" requirement as a further layer of review for IRS adjudications, see Steve R. Johnson, *Reasoned Explanation and IRS Adjudication*, 63 DUKE L.J. 1771, 1833 **Error! Main Document Only.**(2014) (concluding that the addition of reasoned-explanation analysis would be "a bad idea for deficiency determinations and would probably be a bad idea in the contexts of jeopardy and termination determinations, trust fund recovery penalty determinations, and CDP liability determinations. Nevertheless, it would be a good idea for CDP collection determinations, and, pending particularized analysis, might be a good idea as to some other types of IRS adjudications.").

13 FLA. ST. U. BUS. Rev. 77 (2014) (discussing *Home Concrete* and the intersection between administrative law principles and statutory interpretation); James M. Puckett, *Embracing the Queen of Hearts: Deference to Retroactive Tax Rules*, 40 FLA. ST. U. L. REV. 349 (2013) (also discussing retroactivity and arguing that temporary regulations should receive only *Skidmore* deference); David J. Shakow, *A Concrete Shoe for* Brand X*?*, 135 TAX NOTES 651 (2012) (arguing that it is unclear after *Home Concrete* whether an agency, relying on *Brand X* to overturn a judicial decision—such as one decided after *Chevron* that does not explicitly state that the statute is ambiguous—must show that Congress expressly delegated gap-filling authority to the agency). *Home Concrete* is also discussed in more detail in Section 7.03[C][2] of this Supplement.

§ 2.02[B][2] (Courts' Deference to Revenue Rulings)

Notwithstanding the Treasury Department's victory in *Mayo Foundation for Medical Education and Research v. United States*, 562 U.S. 44 (2011), discussed above in Section 2.02[A][2][a] of this Supplement, a representative from the Tax Division of the Department of Justice has announced that the agency will not ask courts to apply *Chevron* deference to Revenue Rulings or Revenue Procedures. *See* Marie Sapirie, *DOJ Won't Argue for Chevron Deference for Revenue Rulings and Procedures, Official Says*, 2011 TAX NOTES TODAY 90-7 (May 10, 2011); *see also* Kathryn Sedo & Katrina Wessbecker, *Should Courts Ever Give Deference to Revenue Procedures?*, 134 TAX NOTES 225 (2012) (arguing that Revenue Procedures are entitled to little or no deference because they generally contain no reasoning and are not promulgated through notice-and-comment rulemaking procedures).

Courts generally apply *Skidmore* to Revenue Rulings and Revenue Procedures. *See* IRS v. Worldcom, Inc. (*In re Worldcom, Inc*.), 723 F.3d 346, 358 (2d Cir. 2013) ("Although not entitled to Chevron deference, particular revenue rulings may be given deference to the extent that they are persuasive—in other words, we will afford them *Skidmore* deference.") (citations omitted); *Kornman & Assocs., Inc. v. United States*, 527 F.3d 443, 455 (2008) ("We believe that our existing jurisprudence regarding the level of deference owed to revenue rulings is fully compatible with *Skidmore*, and we apply that standard today."). *But see* Tualatin Valley Builders Supply, Inc., v. United States, 522 F.3d 937, 941–42 (9th Cir. 2008) (observing that "[o]ur case law leaves unresolved the question whether a revenue procedure should receive *Chevron* or *Skidmore* deference" but finding that the Revenue Procedure in question should be respected under either standard) (citations omitted).

For further discussion of the precedential value of Revenue Rulings, Revenue Procedures, and other forms of guidance, see Tina R. Green & Nikki L. Lang, *IRS Alphabet Soup: Practical and Precedential Value of AODs, IRBs, TAMs, & Other Guidance*, J. TAX PRAC. & PROC., Jun.-July 2013, at 27. For a very recent Tax Court decision according *Skidmore* deference to Revenue Rulings enunciating the so-called "investor control" doctrine, see *Webber v. Commissioner*, 144 T.C. No. 17, 2015 U.S. Tax Ct. LEXIS 27 (2015).

§ 2.04[A] (Areas in Which the IRS Will Not Issue Letter Rulings)

In Revenue Procedure 2013-32, 2013-2 C.B. 55, the IRS "restrict[ed] the scope of letter rulings that address issues with respect to transactions under sections 332, 351, 355, and 1036, and reorganizations within the meaning of section 368 of the . . . Code." It will only rule on issues arising under one of those nonrecognition provisions if the issue is "significant." *Id.* The IRS received an "avalanche" of ruling requests just before the August 2013 effective date of the new policy. *See* Casey Wooten, *IRS Processes Backlog of PLR Requests Resulting From Policy Change*, DAILY TAX REP. (BNA), Mar. 28, 2014, at G-2. However, Lisa Fuller Chief of Corporate, Branch 5 of the IRS Office of Chief Counsel reported at a meeting in March 2014 that the IRS had cleared the backlog. *See id*.

William Alexander, the IRS Associate Chief Counsel (Corporate), explained at a New York State Bar Association Tax Section meeting in June 2013 that the reason for the change in policy was that "because the available resources are 'smaller than they've ever been in the past . . . we've been looking at ways that we could try to preserve the best part of our program in a way that would continue to provide the most utility with fewer resources' . . ." *IRS Ends Rescission Study, Leaving No-Rule in Effect*, 2013 TAX NOTES TODAY 127-1 (July 2, 2013). In October 2013, at a Practising Law Institute tax program, Gerald B. Fleming, an IRS Senior Technician Reviewer in Corporate, Branch 2 of the IRS Office of Chief Counsel said that attorneys who are unsure whether they should request a letter ruling on a reorganization should consult with the IRS. John Herzfeld, *Practitioners Urged to Meet with IRS on Scope of No-Rule Revenue Procedures*, DAILY TAX REP. (BNA), Oct. 21, 2013, at G-1.

The IRS's current list of no-rule areas appears in Revenue Procedure 2015-3, 2015-3 I.R.B 129, which updates Revenue Procedure 2008-3, mentioned in the text. The excerpts in the text from Revenue Procedure 2008-3 generally are restated in the 2015 version of the Revenue Procedure. For a discussion of changes in the IRS's letter ruling program over time, including the expansion of no-rule areas, see George White, The PLR Program, Then and Now, 141 Tax Notes 657 (2013).

§ 2.04[B] (How to Request a Letter Ruling)

Revenue Procedure 2015-1, 2015-1 I.R.B. 1, updates Revenue Procedure 2008-1, included in the text, and sets forth the IRS's current procedure for requesting a letter ruling. Revenue Procedure 2015-1 revises some of the material appearing in the 2008 version of the Revenue Procedure, but the basic instructions for requesting a ruling are nearly identical to those appearing in the text.

In addition, the fees previously listed in Appendix A of Revenue Procedure 2008-1, cited on page 63 of the text, have changed. The most recent schedule can be found in Appendix A of Revenue Procedure 2015-1, 2015-1 I.R.B. 1 app. A. The fee for a traditional letter ruling has more than doubled since 2012, and is now $28,300. *See* Amy S. Elliot, *Letter Ruling Fees Have*

More Than Doubled in 4 Years, 146 TAX NOTES 1585, 1585 (2015). "The IRS said it has increased the fees in recent years because 'more complex rulings come to represent a larger proportion of the rulings that get worked and there is a corresponding increase in the average number of hours spent on each ruling.' It added that the fees were also increased because of a slight increase in average salaries 'mainly due to changes in the composition of the workforce caused by hiring restrictions.'" *Id.*

§ 2.05 (THE "DUTY OF CONSISTENCY")

In a 2012 Action on Decision, the IRS nonacquiesced in International Business Machines Corp. v. United States, 343 F.2d 914 (Ct. Cl. 1965), *cert. denied*, 382 U.S. 1028 (1966), which is discussed on pages 74–75 of the text. *See* AOD 2012-02, 2012-40 I.R.B. 424. The Action on Decision explains, in part:

> The Service's position is that IBM was incorrectly decided. The Service has never agreed with the holding. The government petitioned the United States Supreme Court, albeit unsuccessfully, for a writ of certiorari, plainly stating its disagreement with the holding. . . .
>
> *IBM*'s vitality as precedent has been substantially eroded by later judicial pronouncements, including by both the original forum that decided it and its successor court. The same year that *IBM* was decided, two subsequent decisions of the en banc Court of Claims effectively limited the IBM holding to its facts. See Knetsch v. United States, 348 F.2d 932, 940 n.14 (Ct. Cl. 1965) (limiting *IBM* as "based on the court's evaluation of the particular circumstances in that case"), and Bornstein v. United States, 345 F.2d 558, 564 n.2 (Ct. Cl. 1965) (distinguishing *IBM* on the basis of "controlling factual differences"). More recently, the Court of Federal Claims held that taxpayers "cannot claim entitlement to a particular tax treatment on the basis of a ruling issued to another taxpayer." Fla. Power & Light Co. v. United States, 56 Fed. Cl. 328 (2003), *aff'd*, 375 F.3d 1119 (Fed. Cir. 2004) (rejecting an electric utility's argument that it could rely on private letter rulings issued to other taxpayers in order to seek refunds of heavy vehicle excise taxes). In affirming *Florida Power & Light*, the Court of Appeals for the Federal Circuit cited *Knetsch* and *Bornstein*, *supra*, noting that the en banc Court of Claims itself had limited the *IBM* holding to its facts. The Federal Circuit also hinted that the holding in *IBM* may have been effectively overruled by the Supreme Court's opinion in Dickman v. Commissioner, 465 U.S. 330, 343 (1984), in which the Court acknowledged the Commissioner's authority to change retroactively an earlier interpretation of the law. 375 F.3d at 1124-25 & n.10. . . .

2012-40 I.R.B. 424, at 425 (citation omitted).

For further reading on the "duty of consistency," see Stephanie Hoffer, *Hobgoblin of Little Minds No More: Justice Requires an IRS Duty of Consistency*, 2006 UTAH L. REV. 317 (arguing that "[i]nstead of resulting in a race to the bottom or a lowest common denominator system of taxation as courts have predicted, application of a broad duty of consistency to the Service would improve the quality of written advice while furthering fair administration of the revenue laws"); Steve R. Johnson, *An IRS Duty of Consistency: The Failure of Common Law Making and a Proposed Legislative Solution*, 77 TENN. L. REV. 563 (2010) (advocating for statutory interest abatement for taxpayers who relied on a regulation, Revenue Ruling, Revenue Procedure, or IRS Notice that the IRS did not follow).

Chapter 3

§ 3.02[A] (Formal Requirements of a Return)

In 2012, the IRS issued a Revenue Procedure that addresses when a taxpayer qualifies for abatement of the $5,000 frivolous return penalty in Code section 6702. Rev. Proc. 2012-43, 2012-2 C.B. 681; *see also* I.R.C. § 6702(d) (granting the IRS the authority to abate the penalty). According to the Revenue Procedure, taxpayers who abandon any frivolous positions may qualify for a one-time reduction in the penalty to $500 if they satisfy the following requirements: (1) File a request for relief on Form 14402, *IRC 6702(d) Frivolous Tax Submissions Penalty Reduction*; (2) pay at least $250 of the penalty with the request; (3) file the request before the IRS files suit to collect the full penalty; (4) establish that the taxpayer is in full compliance by having filed any tax returns for all tax periods within six years before the request; and (5) establish that the taxpayer has paid in full all tax liabilities, interest, and penalties (other than the section 6702 penalty) for all periods for which the statute of limitations remains open. Rev. Proc. 2012-43, *supra*, at § 4. The penalty relief does not apply to any section 6702 penalty that has already been paid. *Id*. at § 3.

§ 3.02[B] (Filing of Tax Returns)

The Treasury Department has amended and finalized proposed regulations under section 7502, mentioned on the bottom of page 88 of the text. The regulations provide ways to establish prima facie evidence of delivery when direct proof of actual delivery does not exist. According to the proposed version of the regulations, besides proof of actual delivery, the exclusive means to establish prima facie evidence of delivery is through registered or certified mail. Prop. Reg. § 301.7502-1(e), 69 Fed. Reg. 56377, 56379 (Sept. 21, 2004). The final regulations expand upon the proposed version, allowing the proper use of IRS-authorized private delivery services to serve as prima facie evidence of delivery. *See* T.D. 9543. The circuit split on the issue of whether other evidence, such as taxpayer testimony, serves as proof of the actual mailing date remains. For a discussion of this case law, see Philip N. Jones, *Circuits Split Over the Mailbox Rule, But IRS Issues a Fix*, 115 J. TAX'N 278 (2011). *See also* Maine Med. Ctr. v. United States, 675 F.3d 110 (1st Cir. 2012) (citing the newly enacted final regulations while denying the taxpayer's efforts to come within section 7502). *Maine Medical* is discussed in Section 10.05 of this Supplement.

Based on the discussion in Section 2.02[A], if a taxpayer were to challenge the validity of the section 7502 regulations, how would the reviewing court analyze the issue?

§ 3.02[C] (Filing Extensions)

On page 89, in the fourth line of footnote 7, replace the word "extended" with "regular."

Final regulations under section 6081 allow for an automatic five-month extension to file returns for partnerships, trusts, and estates. T.D. 9531. The Treasury rejected the idea of a six-month extension for these pass-through entities, fearing the difficulties this could create for individuals. According to the regulations' preamble, the five-month extension "strikes the most reasonable balance for these passthrough entities and the large number of taxpayers who require information from these entities for completion of their income tax returns." *Id*.

§ 3.03[B][1][a] (DIF Scores and Other Methods)

In an effort to improve tax compliance and administration, the IRS announced during 2010 that it would require certain business taxpayers to report their uncertain tax positions to the IRS. *See* I.R.S. Announcement 2010-9, 2010-1 C.B. 408. While many taxpayers are required by FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), to establish a reserve for income taxes when a tax position fails to satisfy a more-likely-than-not confidence threshold, tax returns do not currently require that taxpayers identify to the IRS uncertain tax positions. FASB INTERPRETATION NO. 48, ACCOUNTING FOR UNCERTAINTY IN INCOME TAXES (2006).

The Uncertain Tax Positions (UTP) compliance program requires business taxpayers that (1) issue audited financial statements and (2) have total assets in excess of $100 million to provide information to the IRS about uncertain tax positions that affect their federal income tax liability. I.R.S. Announcement 2010-75, 2010-2 C.B. 428. Starting with the 2012 taxable year, the reporting threshold declined to $50 million, and for taxable year 2014 and after, the threshold drops to $10 million. *Id.* An uncertain tax position, for these purposes, includes a tax position for which a tax reserve was recorded in audited financial statements and any position related to the determination of any federal income tax liability for which a taxpayer or related entity has not recorded a reserve because the taxpayer expects to litigate the position. *See* Announcement 2010-09, *supra*; Announcement 2010-75, *supra*.

Affected taxpayers file the disclosure schedule, Schedule UTP, with Form 1120 or other business tax returns for taxable years beginning in 2010. Announcement 2010-75, *supra*. The schedule requires (1) a description of the relevant facts affecting the tax treatment of the position, and (2) information that can reasonably be expected to apprise the IRS of the identity of the tax position and the nature of the issue. *Id*. The initial draft of Schedule UTP required the taxpayer to provide the type of item reported (income, gain, loss, deduction, or credit) and the rationale behind it. Announcement 2010-09, *supra*. It also required the taxpayer to calculate and report the maximum amount of potential federal tax liability attributable to each uncertain tax position. *Id.* The current version of Schedule UTP eliminates these requirements. In fact, the instructions specifically direct taxpayers not to provide an assessment of the hazards of litigation associated with each position or an analysis of the support for or against the position. *See* Instructions for 2014 Schedule UTP, *available at* http://www.irs.gov/pub/irs-pdf/i1120utp.pdf. The instructions include several examples. The IRS has also recently updated a list of frequently asked questions relating to Schedule UTP. *See* Frequently Asked Questions on Schedule UTP, *available at* http://www.irs.gov/Businesses/Frequently-Asked-Questions-on-Schedule-UTP.

Announcement 2010-30 reserves the question of what penalties, if any, might be imposed on taxpayers who fail to file the required disclosure form or file it with inadequate information. I.R.S. Announcement 2010-30, 2010-1 C.B. 668. In Announcement 2010-09, the IRS stated that it was considering efforts to propose new legislation that would penalize taxpayers for failure to file Schedule UTP or for inadequate disclosure. Announcement 2010-09, *supra*. To date, no legislation has been proposed.

Then-IRS Commissioner Douglas Shulman outlined the purpose behind the UTP compliance program. According to Shulman:

> Today, we spend up to 25 percent of our time in a large corporate audit searching for issues rather than having a straightforward discussion with the taxpayer about the issues. It would add efficiency to the process if we had access to more complete information earlier in the process regarding the nature and materiality of a taxpayer's uncertain tax positions. The goals of our proposal are simple: to cut down the time it takes to find issues and complete an audit . . . ensure that both the IRS and taxpayer spend time discussing the law as it applies to their facts, rather than looking for information . . . and to help us prioritize selection of issues and taxpayers for examination.

Douglas Shulman, *New York State Bar Ass'n Tax Section Annual Meeting* (Jan. 26, 2010), I.R.S. News Release IR-2010-13, *available at* 2010 TAX NOTES TODAY 17-15 (Jan. 27, 2010). The IRS has announced that it will use the disclosed information only to identify potential noncompliance. It will then use traditional examination techniques to analyze the underlying issues. *See* Stephen Joyce, *IRS Will Not Use Schedule UTP to Analyze Uncertain Tax Positions, Wilkins Says*, DAILY TAX REP. (BNA), June 23, 2010, at G-2.

Once the program was announced, many practitioners expressed concern that the disclosure obligation would provide the IRS with a roadmap to firms' tax planning strategies and place a substantial burden on those required to complete the statements. *See, e.g.*, *id.*; Alison Bennett, *Taxpayers Aim Criticism at IRS Proposal on Disclosure of Uncertain Tax Positions*, DAILY TAX REP. (BNA), Apr. 5, 2010, at G-4. After the first filing season concluded, most practitioners reported that the process was not as bad as they expected. *See* Amy S. Elliott, *Post-UTP Reveal—Relief or Restlessness?*, 134 TAX NOTES 31 (2012); Shamik Trivedi, *UTP Filing Season Better Than Tax Directors Expected*, 133 TAX NOTES 960 (2011).

According to IRS statistics, as of April 20, 2015, approximately 2,090 taxpayers had filed Schedule UTP for tax year 2013, which represents a decrease compared with both 2012 (2,399 filed) and 2011 (2,271 filed). *See* UTP Filing Statistics, http://www.irs.gov/Businesses/Corporations/UTPFilingStatistics (containing selected 2010-2013 Schedule UTP statistics). The 2013 schedules resulted in 5,110 disclosed items. The three issues most frequently disclosed by taxpayers related to the research and experimentation credit under section 41, transfer pricing issues under Code section 482, and capitalization of business expense issues under section 263. *Id*.

Commentators have expressed concern that the disclosure requirement is inconsistent with the IRS's "policy of restraint," an internal policy directive advising IRS agents to request audit or tax accrual workpapers from taxpayers only in unusual circumstances. *See* IRS Service Policy for Requesting Workpapers, IRM 4.10.20.3 (July 12, 2004). In response to these concerns, the IRS issued Announcement 2010-76, 2010-2 C.B. 432, which allows taxpayers who are asked to submit workpapers as part of an examination to redact drafts, revisions, and comments made while preparing the Schedule UTP. The Announcement also assures taxpayers that, if a document is otherwise privileged and was provided to an independent auditor as part of an audit of the taxpayer's financial statement, the IRS will not assert during an examination that the privilege has been waived by the disclosure. *See id.* For a discussion of how the disclosure requirements could affect the application of the attorney-client, FATP, and work product privileges, see George M. Gerachis & David C. Cole, *The Uncertain World of Uncertain Tax Position Disclosures and Privilege*, DAILY TAX REP. (BNA), Apr. 2, 2012, at J-1.

§ 3.03[B][1][b] (Whistleblowers)

For several years now, the IRS has released its statistics on whistleblower submissions and awards. In 2009, the IRS reported receiving over 5,000 cases. The IRS paid out more than $5.8 million in awards in 2009, across 110 cases, from approximately $206 million collected. IRS, *Fiscal Year 2009 Annual Report to Congress on the Use of Section 7623* at 8, *available at* http://www.irs.gov/pub/irs-utl/whistleblowerfy09rtc.pdf. Figures in 2010 reveal 7,577 reported cases, over $18 million in whistleblower awards, and $464 million collected. IRS, *FY 2010 Report to the Congress on the Use of Section 7623* at 12 Tbl. 2, *available at* http://www.irs.gov/pub/whistleblower/annual_report_to_congress_fy_2010.pdf. Note that all claims and awards up to and including those made in 2010 were made under Code section 7623(a). *Id*. at § V.

The IRS began paying awards for claims made under section 7623(b) in 2011. IRS, *FY 2014 Report to the Congress on the Use of Section 7623*, at 4, *available at http://www.irs.gov/pub/whistleblower/WB_Annual_Report_FY_14_Final_Signature_June_11-signed%20corrected.pdf*. According to the IRS's most recent figures, in 2014 the agency received 352 whistleblower submissions that appeared to meet the required $2 million threshold. *Id*. at 14 Tbl. 2. During the same year, the IRS paid informants $52 million in awards and collected a little over $309 million from taxpayers identified under the whistleblower program. *Id*. at 21 Tbl. 6. Awards and amounts collected in 2014 were relatively small in comparison with 2012, when the IRS paid out over $125 million to whistleblowers and collected nearly $600 million from taxpayers. *Id.* The reason is that several of the payments in 2012 were large, including a $104 million award to Bradley Birkenfeld, who provided information to the IRS about Swiss bank UBS's illegal offshore banking operations that led to penalties for the bank and the collection of more than $5 billion in unpaid taxes from some of the bank's customers.

Michael Bologna, *Birkenfeld Award Enhances Credibility of IRS Whistleblower Program, Official Says*, DAILY TAX REP. (BNA), Jan. 29, 2013, at G-1.

In 2014, the IRS issued final regulations under section 7623 that provide a comprehensive framework for the receipt of whistleblower submissions and the determination of whistleblower awards. T.D. 9687 (Aug. 7. 2014). The regulations replace proposed regulations and amend final regulations issued in 2012.

The new section 7623 regulations provide, in part, that the IRS will pay out awards when the information provided "substantially contributes" to an action against a person identified by the whistleblower. Treas. Reg. § 301.7623-2(b)(1). Information substantially contributes to an action when the information received by the informant causes the IRS to initiate a new action or investigation, expand the scope of an ongoing action that it would not otherwise have expanded, or continue to pursue an ongoing action that it would not have continued but for the information provided. *Id*. The regulations define "collected proceeds" (the base upon which a whistleblower award will be determined) to include tax, penalties, interest, and additional amounts collected by reason of the information provided. The definition does not include criminal fines. Treas. Reg. § 301.6723-2(d). According to one commentator, the new final regulations will require the IRS to rewrite the existing whistleblower provisions in the Internal Revenue Manual. *See* Andrew Velarde, *Whistleblower Regs' Tax Attribute Rule Is a "Double-Edged Sword,"* 144 TAX NOTES 1534, 1535 (2014). To date, the Manual has not been updated.

As noted in the text on page 93, Code section 7623(b)(4) grants an informant the right to appeal IRS whistleblower award determinations to the Tax Court. The taxpayer in *Cooper v. Commissioner*, 136 T.C. 597 (2011), alerted the IRS to an alleged tax underpayment in connection with estate and generation-skipping taxes, and sought a whistleblower award. The IRS reviewed the matter, decided not to pursue it, and denied the award. *Id.* at 599. The taxpayer appealed the denial to the Tax Court. *Id.* The court granted summary judgment to the IRS, and, in the process, rejected the informant's request that the court force the IRS to re-investigate the underlying case to determine whether the taxpayer owed a deficiency:

> Petitioner seeks to litigate whether any Federal estate tax or gift tax is due from the taxpayer. Our jurisdiction in a whistleblower action is different from our jurisdiction to review a deficiency determination. We have jurisdiction in a deficiency action to redetermine whether there is any income, estate or gift tax due. *See* sec. 6214(a). In a whistleblower action, however, we have jurisdiction only with respect to the Commissioner's award determination. *See* sec. 7623(b). Our jurisdiction under section 7623(b) does not contemplate that we redetermine the tax liability of the taxpayer.
>
> Moreover, although Congress authorized the Court to review the Secretary's award determination, Congress did not authorize the Court to direct the Secretary to proceed with an administrative or judicial action. Congress has

> charged the Secretary with the responsibility of seeking tax revenue in every possible situation. Secs. 7601 and 7602. Respondent has explained why he determined that there was no estate or gift tax due on the facts petitioner presented. Petitioner may disagree with respondent's legal conclusions for why there was no Federal estate or gift tax due. Nevertheless, whistleblower awards are preconditioned on the Secretary's proceeding with an administrative or judicial action. Sec. 7623(b)(1). If the Secretary does not proceed, there can be no whistleblower award.
>
> Finally, respondent properly processed petitioner's whistleblower claims but did not collect any amount of tax, interest or penalty from the taxpayer based on petitioner's information. Because a whistleblower award is calculated as a percentage of collected proceeds, if the Commissioner collects no proceeds there can be no whistleblower award. Sec. 7623(b)(1).

Id. at 600–01. *See also* Cohen v. Commissioner, 139 T.C. 299 (2012) (holding that section 7623 does not confer upon the Tax Court the authority to compel the IRS to initiate an administrative or judicial action based on a whistleblower's claim, nor does the Tax Court have the authority to grant equitable relief to a whistleblower whose claim is not pursued by the IRS), *aff'd*, 2014 U.S. App. LEXIS 1328 (D.C. Cir. 2014).

§ 3.03[B][3] (Specialized Audit Programs for Business Taxpayers)

The IRS has made permanent the Compliance Assurance Process (CAP) program for large corporate taxpayers. *See* I.R.S. News Release IR-2011-32 (Mar. 31, 2011), *available at* http://www.irs.gov/uac/IRS-Expands-and-Makes-Permanent-Its-Compliance-Assurance-Process-(CAP)-for-Large-Corporate-Taxpayers. The agency is also in the process of expanding the program and updating the CAP procedures. *See* IRS Compliance Assurance Process (CAP), IRM 4.51.8 (June 15, 2012), *available at* http://www.irs.gov/irm/part4/irm_04-051-008.html. According to the IRS, the CAP program will include two new components: (1) a pre-CAP program that specifies to interested taxpayers the steps required to participate in the program; and (2) a CAP maintenance program for taxpayers who have a track record of working cooperatively with the IRS. *Id.* For a detailed discussion of how the CAP program operates, see Deborah Nolan & Frank Ng, *The Compliance Assurance Process: Shifting the Paradigm—Is it Right for You?*, DAILY TAX REP. (BNA), July 1, 2011, at J-1.

§ 3.04[A] (Introduction to Direct and Indirect Methods of Reconstructing a Taxpayer's Income)

Maciel v. Commissioner, T.C. Memo. 2004-28, cited on page 101 of the text, was reversed in part on other grounds, 489 F.3d 1018 (9th Cir. 2007).

For a short overview of the indirect methods of reconstructing income, see Charles P. Rettig, *Overview: Indirect Methods of Determining Taxable Income,* J. TAX PRAC. & PROC., Feb.-Mar. 2014, at 19, 19–24.

§ 3.04[C][2] (The Bank Deposits Plus Cash Expenditures Method)

In 2011, the IRS updated several sections of the *Internal Revenue Manual* (IRM), including some related to the Bank Deposits and Cash Expenditures Method. IRM 4.10.4.6.4.6 now shows the line-by-line formula used to calculate gross receipts for purposes of this method. Gross receipts is computed as follows:

1. Total bank deposits

Less:

2. Nontaxable receipts deposited

3. Net deposits resulting from taxable receipts

Add:

4. Business expenses paid by cash

5. Capital items paid by cash (personal and business)

6. Personal expenses paid by cash

7. Cash accumulated during the year from receipts

Subtract:

8. Nontaxable cash used for lines 4-7.

For accrual basis taxpayers:

9. For accounts receivable, subtract the beginning balance from the ending balance. A net increase represents additional taxable gross receipts and is added here. A net decrease represents payments included in prior year gross receipts and is subtracted here.

10. For accounts payable, subtract the beginning balance from the ending balance. A net increase represents purchases on account during the year and is subtracted here. A net decrease represents payments on accounts and is added here.
11. Gross Receipts as corrected.

IRM 4.10.4.6.4.6 (emphasis added). For an example of the application of the Bank Deposits and Cash Expenditures Method, see IRM Ex. 4.10.4-9.

Chapter 4

§ 4.02[A] (Scope of Authority)

A Chief Counsel Advice memorandum has concluded that an IRS examiner may summon a taxpayer's original electronic data files to obtain any associated metadata even if the taxpayer volunteers to provide printed copies of the files. CCA 201146017 (Nov. 18, 2011), *available at* http://www.irs.gov/pub/irs-wd/1146017.pdf. Metadata "is information that describes how, when, and by whom a particular item or set of electronic information was collected, created, accessed, modified, and formatted." *Id.* According to the memorandum, the phrase "books, papers, records, and other data" in Code section 7602 is "more than broad enough to encompass the compelled production of the metadata associated with electronic documents." *Id.* On the question of whether the data is relevant to the examination, the drafters concluded that metadata may be relevant within the meaning of section 7602(a) "because the nature of the information contained in the metadata, especially the dates on which the entries were made or modified and the identities of the persons entering the data, may support or undermine the credibility of the records offered to substantiate the accuracy of the return." *Id.* The drafters also noted that Federal Rule of Civil Procedure 34, which specifically addresses the production of electronically stored information, and associated case law supported its view that discovery of metadata was appropriate even when the subject of the summons provided hard copies of the requested records. *Id.*

A recent policy announcement from the IRS states that the agency will seek a formal search warrant in all cases in which it requests the content of email communications stored by internet service providers (ISPs). IRS Policy Statement 4-120 (Mar. 19, 2014), *available at* http://www.irs.gov/uac/Newsroom/IRS-Statement-on-Obtaining-eMails. The statement clarifies that the IRS will not seek emails from ISPs during civil administrative proceedings. *Id*.

As noted at the end of Section 3.03 of the text, the IRS commonly requests information from taxpayers during an audit by issuing an Information Document Request (IDR) before it issues a formal summons. Recently, the IRS's Large Business & International (LB&I) Division released new guidance relating to the enforcement of IDRs. *See* IRS Directive LB&I-04-0214-004 (Feb. 28, 2014), *available at* http://www.irs.gov/Businesses/Large-Business-and-International-Directive-on-Information-Document-Requests-Enforcement-Process. The new procedures require auditors in the LB&I Division to follow a three-step process once the taxpayer fails to respond to the IDR. If the taxpayer is delinquent, the auditor must (1) issue a delinquency notice giving the taxpayer a specified date by which to provide the information; (2) if the delinquency continues, issue a pre-summons letter granting the taxpayer additional time to comply; and (3) if the taxpayer still does not comply, initiate the process to enforce the summons. The new procedures are mandatory. *Id*.

The IRS maintains that the new policies should increase the efficiency of the IDR process and reduce the need to issue summonses for taxpayer information. *See* John Keenan et al., *New Mandatory IDR Enforcement Procedures for LB&I Examinations*, 45 TAX ADVISER 167 (2014). Several commentators have expressed concerns that the new procedures are too rigid and take away the discretion of IRS auditors to decide how best to conduct the examination. Alison Bennett, *Practitioners Urge IRS to Provide Flexibility to Agents in Audits Using New IDR Process*, DAILY TAX Rep. (BNA), Feb. 17, 2014, at G-1; *Practitioners Wary of New IDR Enforcement Process, Sullivan & Cromwell Memo Says*, DAILY TAX REP. (BNA), Nov. 20, 2013, at G-4. Many practitioners also were concerned that the number of summonses issued by the LB&I Division would increase after the IDR procedures were put in place, but the IRS reports that no surge in summonses has occurred. Laura Davison, *Lack of Summonses Quells Practitioner Fears Over LB&I Document Requests*, DAILY TAX REP. (BNA), Apr. 16, 2015, at G-7.

§ 4.02[C] (Third-Party Summonses)

Code section 7609 requires that, in the case of a third party summons, the IRS must give the taxpayer notice at least 23 days before the date the records are to be examined. I.R.C. § 7609(a). In *Jewell v. United States*, 749 F.3d 1295 (10th Cir. 2014), the Court of Appeals for the Tenth Circuit ruled that the IRS could not obtain an order enforcing a third-party summons when it failed to give the taxpayer the required notice.

The IRS issued a series of summonses to banks in Oklahoma for records relating to nursing homes owned by Mr. Jewell. The IRS sent the notices required by Code section 7609 to Jewell, but he received them fewer than 23 days before the examination date. The taxpayer filed motions to quash in two federal district courts in Oklahoma. The two district courts disagreed on how to interpret the notice requirement. The District Court for the Western District of Oklahoma denied the taxpayer's motion to quash, ruling that Mr. Jewell had received notice of the summonses within time to file his petition to quash. The district court for the Eastern District granted the taxpayer's motion and denied the government's motion to dismiss because the IRS failed to timely satisfy the notice requirement. *Id*. at 1297.

On appeal, the Tenth Circuit ruled that that the 23-day notice requirement was mandatory and that it was an "administrative step" under the fourth prong of the *Powell* test, which requires that, in order for the IRS to make a *prima facie* case for enforcement, it must establish that it followed the required administrative steps in the Code. *Id.* at 1298–99. The IRS's failure to satisfy that fourth prong meant that the summonses were not enforceable. *Id.* at 1300.

The Tenth Circuit's ruling deepened a split among the circuits over how the notice provision in section 7609(a) should be applied. At least one circuit does not view the requirement as an administrative step, *see* Sylvestre v. United States, 978 F.2d 25, 28 (1st Cir. 1992), while several other courts recognize the requirement but also assume equitable power to excuse lack of timely notice if the taxpayer was not prejudiced in filing the motion to quash, *see*

Cook v. United States, 104 F.3d 886, 889-90 (6th Cir. 1997), Adamowicz v. United States, 531 F.3d 151, 161 (2d Cir. 2008). The Tenth Circuit ruled, instead, that the penalty for failure to provide the required notice to the taxpayer is an automatic bar to enforcement. The Tenth Circuit explained:

> Though we do not lightly create a circuit split, we are obliged to follow Supreme Court precedent, even when it might be viewed as "inequitable" or as "form over substance." In *Powell*, the Supreme Court expressed itself clearly: If the IRS does not comply with the administrative requirements of the Internal Revenue Code, its summonses are unenforceable. *United States v. Powell,* 379 U.S. 48, 57-58, 85 S. Ct. 248, 13 L. Ed. 2d 112 (1964). The 23-day requirement is mandatory and an administrative requirement of the Internal Revenue Code. Thus, under *Powell*, we conclude that the district courts in the Western and Eastern Districts of Oklahoma were obligated to grant Mr. Jewell's petitions to quash the summonses.

Jewell, 749 F.3d at 1300–01.

§ 4.02[D] (John Doe Summonses)

As part of a highly publicized crackdown on the use of offshore banking services to avoid U.S. taxes, in 2008, the Department of Justice, on behalf of the IRS, served a John Doe summons on Swiss bank UBS seeking the names of some 52,000 U.S. taxpayers with undeclared accounts at the Swiss bank. After UBS refused to comply with the summons, the Department of Justice sought an order from the United States District Court for the Southern District of Florida seeking enforcement. Kristen A. Parillo & Randall Jackson, *U.S. Won't Drop UBS John Doe Summons, Justice Department Says,* 123 TAX NOTES 1503 (2009). UBS objected to the summons by claiming that enforcement would violate Swiss privacy laws as well as treaties between Switzerland and the U.S. The Department's memorandum supporting enforcement contended that Swiss privacy laws are not absolute and that the U.S. had satisfied all of the *Powell* factors. United States v. UBS AG, No. 09-20423-CIV-GOLD/MCALILEY (June 30, 2009).

The judge in the summons enforcement proceeding postponed his decision in order to give the parties time to negotiate a settlement. Eventually, UBS agreed to turn over the names of more than 4,400 U.S. clients suspected of using UBS accounts to evade U.S. tax. Lynnley Browning, *Names Deal Cracks Swiss Bank Secrecy*, N.Y. TIMES, Aug. 20, 2009, at A1. After the agreement was negotiated, a federal administrative court in Switzerland blocked disclosure of the names, thereby forcing the Swiss parliament to approve the agreement. The lower house of parliament initially rejected the agreement and insisted that the matter be put to a referendum of the Swiss voters. Both houses of the Swiss parliament subsequently approved the disclosure agreement, and most of the previously undisclosed account holder names have been released to the IRS. David D. Stewart, *Swiss Parliament Approves UBS Agreement, Rejects Referendum,* 127 TAX NOTES 1311 (2010). Because of its success in obtaining account information from

UBS, the IRS withdrew its John Doe summons. Sam Young, *IRS Withdraws John Doe Summons Against UBS*, 129 TAX NOTES 876 (Nov. 22, 2010). Subsequently, the Department of Justice created a series of settlement programs that would allow other Swiss banks to share information about U.S.-owned bank accounts and to pay fines to avoid prosecution for helping clients to conceal assets and evade tax. Erin McManus, *Keneally Says DOJ Tax Division Moving Forward with Swiss Bank Letters of Intent*, DAILY TAX REP. (BNA), Apr. 10, 2014, at G-1.

During the controversy with UBS, U.S. and Swiss tax authorities negotiated an update to the bilateral tax treaty between the countries to facilitate exchanges of information about U.S. citizens with Swiss bank accounts who are suspected of tax evasion. The Swiss authorities have ratified the update protocol but the U.S. Senate has not. Stephanie S. Johnston & David D. Stewart, *Swiss Court Blocks Turnover of Bank Data to IRS*, 135 TAX NOTES 262 (2012). Notwithstanding the fact that the treaty updates have not been ratified, the IRS and the Department of Justice continue to pressure the Swiss government to pass legislation that would require Swiss banks to disclose information about U.S. persons with accounts at Swiss financial institutions. *See* Daniel Pruzin, *Swiss Lawmakers Must Accept Government Plans to Cede Client Data, Work with DOJ*, DAILY TAX REP. (BNA), June 9, 2013, at I-4.

In another effort to identify taxpayers hiding income offshore, the Department of Justice asked a federal judge to serve a John Doe summons on the Hong Kong and Shanghai Banking Corporation of India (HSBC India) seeking the names of U.S. taxpayers who may be using accounts at the bank to evade U.S. tax. *In re John Does*, No. CV 11-1686 LB (N.D. Cal. Apr. 7, 2011); *see also In re Tax Liabilities of John Does*, No. 13-CV-01938 (N.D. Cal. Apr. 29, 2013) (authorizing IRS to serve a John Doe summons to Wells Fargo N.A. seeking information about U.S. taxpayers with offshore accounts at FirstCaribbean International Bank). For further reading about the government's crackdown on offshore tax evasion, including a summary of its use of John Doe summonses, criminal prosecutions, and "voluntary disclosure" amnesties, see Leandra Lederman, *Taxation of Offshore Accounts: The Use of Voluntary Disclosure Initiatives in the Battle Against Offshore Tax Evasion*, 57 VILL. L. REV. 499 (2012).

§ 4.03 (DEFENSES TO SUMMONS ENFORCEMENT)

In 2010, the Court of Appeals for the Ninth Circuit modified the District Court's order in *United States v. Bright*, 2007 U.S. Dist. LEXIS 67306, quoted on pages 131–32 of the text. *See* United States v. Bright, 596 F.3d 683 (9th Cir. 2010). With respect to the "foregone conclusion" exception, the Court of Appeals stated:

> For this foregone conclusion exception to apply, the government must establish its independent knowledge of three elements: the documents' existence, the documents' authenticity and respondent's possession or control of the documents. *See United States v. Hubble*, 530 U.S. 27 . . . (2000). The government bears the burden of proof and must have had the requisite knowledge

before issuing the summons or subpoena. *See In re Grand Jury Subpoena*, 383 F.3d at 910.

The Brights argue that the district court clearly erred in finding that the act of producing records concerning offshore bank accounts had no testimonial significance, foreclosing a claim of privilege under the Fifth Amendment. We conclude that the foregone conclusion exception does apply to documents related to the two credit cards expressly named in the summonses. *The exception, however, does not apply to documents concerning the two additional credit cards named during contempt proceedings, and the production of those documents is therefore privileged under the Fifth Amendment.*

The IRS independently knew about the existence of documents related to the first two credit cards before it issued the summonses. In the initial enforcement proceeding, an IRS agent declared under oath that the IRS Offshore Credit Card Project had gathered information showing that the Brights maintained accounts at both Hallmark Trust and Butterfield Bank and provided the Brights' account numbers to the court. The government also showed that Hallmark Trust and Butterfield Bank provided their account holders with specific account documents, demonstrating the existence of particular documents responsive to the summonses. *See [United States v.] Norwood*, 420 F.3d at 895–96 (applying foregone conclusion exception when the government could demonstrate the existence of accounts and account documents even though it did not enumerate specific responsive documents); *cf. [United States v.] Hubbell*, 530 U.S. at 44–45 (holding foregone conclusion exception did not apply to request for broad categories such as "tax records" when the government made no showing "that it had any prior knowledge of either the existence or the whereabouts of the 13,120 pages of documents ultimately produced" under an immunity agreement); *[United States v.] Doe*, 465 U.S. at 607 n.1, 612–14 & n.13 (holding foregone conclusion exception did not apply to subpoena naming 28 broad categories of documents such as "financial statements" and "workpapers").

* * *

On the other hand, application of the foregone conclusion exception to records of the two additional credit cards not named during the enforcement proceeding was clear error. The government asserts that at the time the IRS issued the summonses, it knew of the cards' existence and of their use by Cherie's business partner. However, the government made no showing that it knew that the Brights maintained possession or control of the accounts and thus of the account documents. The government may not issue a summons for "other" documents and then apply the foregone conclusion exception when it becomes aware of documents through an ongoing investigation. *See In re Grand Jury Subpoena*, 383 F.3d at 911. Therefore, the act of producing these documents is

> protected by the Fifth Amendment. The enforcement order is narrowed accordingly to exclude documents related to these two credit cards.

Id. at 692–94 (emphasis added) (footnote omitted).

United States v. Sideman & Bancroft, LLP, 704 F.3d 1197 (9th Cir. 2013), also focused on the "foregone conclusion" exception. In *Sideman*, the IRS obtained a warrant to locate tax documents pertaining to Mary Nolan, who was under criminal investigation for tax evasion. *Id.* at 1199. The authorized search did not turn up the documents but did reveal the name of Ms. Nolan's tax preparer. A special agent contacted the tax preparer, who said that she had given Ms. Nolan's documents to her civil tax attorney. *Id.* at 1199–1200. The agent then contacted that civil attorney, who said that he had forwarded the documents to Ms. Nolan's criminal defense attorney. *Id.* at 1200. The IRS then issued a summons to the defense attorney, but he refused to relinquish the documents, claiming that doing so would violate Ms. Nolan's rights under the Fifth Amendment. *Id.*

The District Court granted the IRS's petition to enforce the summons, "finding that the summonsed documents fell within the 'foregone conclusion' exception to the Fifth Amendment." *Id.* at 1201. On appeal, the Ninth Circuit affirmed. Judge Wallace, writing for the panel, stated that the "'quantum of information' possessed by the IRS prior to its issuance of the summons as to the existence and possession of the summonsed documents [was] substantial." *Id.* at 1202. Not only did the IRS know that Ms. Nolan's tax records existed; it had "precise knowledge of the location" of the documents—in the hands of Ms. Nolan's criminal defense attorney. *Id.* Thus, the "existence" and "possession" prongs of the foregone conclusion exception were satisfied. As for the "authenticity" prong, the IRS had received detailed information from Ms. Nolan's tax preparer, who was sufficiently familiar with the documents to "independently verify that the tax documents [were] what they purport[ed] to be." *Id.* at 1204. Moreover, the IRS could authenticate the documents without Ms. Nolan's contribution. *Id.* The Court of Appeals therefore concluded that "the district court did not err in applying the foregone conclusion exception when enforcing . . . compliance with the summons." *Id.* at 1205.

On the more general topic of defenses to summonses, *United States v. Veolia Environment North America Operations, Inc.*, Civ. No. 13-mc-03-LPS, 2013 U.S. Dist. LEXIS 153245 (D. Del. Oct. 25, 2013) contains a nice summary of work product protection, attorney-expert communications, attorney-client privilege, and tax practitioner privilege, as does the 2014 opinion in the same case, *United States v. Veolia Environment North America Operations, Inc.*, Civ. No. 13-mc-03-LPS, 2014 U.S. Dist. LEXIS 154717, at *6 (D. Del. Oct. 31, 2014), *modified*, 2014 U.S. Dist. LEXIS 163142 (D. Del. Nov. 17, 2014), *reconsideration denied*, 2015 U.S. Dist. LEXIS 93071 (D. Del. July 17, 2015).

The underlying issue in *Veolia* litigation was a $4.5 billion deduction for worthless stock in a subsidiary. In its 2013 opinion in *Veolia*, the District Court concluded that the taxpayer had "subjectively and reasonably anticipated litigation" with the IRS. *Id.* at *18. The court also agreed with the government that while Fed. R. Civ. P. 26(b)(4), which addresses discovery related to experts, protects communications between a taxpayer's attorney and a testifying expert, it does not protect information provided to the expert by someone other than the attorney. *Id.* at *20. The court did not resolve the parties' disagreement over the production of specific documents but concluded with the hope that its "findings and conclusions . . . will assist the parties in resolving, in whole or at least in substantial part, their disputes with respect to the withheld documents." *Id.* at *26.

In late 2013, the parties told the court that 92 documents remained in dispute. "[T]he Court ordered Taxpayer to submit the remaining documents in dispute for in camera inspection" and to create a privilege log briefly describing the privilege claimed for each document. *Veolia*, 2014 U.S. Dist. LEXIS 154717, at *6. In October 2014, the District Court issued its opinion on that dispute. The court addressed each category of documents, explaining why it is protected by a privilege, such as the attorney-client or tax practitioner privilege, or if the taxpayer's actions resulted in a waiver of the privilege. *See, e.g.*, *id.* at *20–28.

Because a number of the disputed documents involved communications between the taxpayer and its expert witness, much of the opinion focuses on Fed. R. Civ. P. 26(b)(4). For example, the court found documents "labeled as 'draft valuation letters' and 'draft valuation presentations'" relating to the valuation of the subsidiary's stock protected by Rule 26(b)(4)(B) because that Rule "extends work-product protection to 'drafts of any report or disclosure required under Rule 26(a)(2), regardless of the form in which the draft is recorded.'" *Id.* at *12–14. Similarly, and consistent with its earlier opinion, the court distinguished between attorney and non-attorney communications with testifying experts, finding only the former protected by the work-product privilege, *id.* at *16, because "Rule 26(b)(4)(C) does not erase the general rule that work-product protection is waived when material is disclosed to a testifying expert. . . ." *Id.* at *17–18.

One of the biggest developments relating to defenses to summonses was *United States v. Clarke*, 134 S. Ct. 2361 (2014), decided by the U.S. Supreme Court in June 2014. The issue in *Clarke* was whether a taxpayer who received an IRS summons may question the IRS about its motives in issuing the summons, in order to determine whether the IRS met the requirement that the summons be issued in good faith. *Id.* at 2363. In *Clarke*, the IRS had investigated certain large interest deductions of Dynamo Holding Limited Partnership (Dynamo) for the 2005-2007 tax years. *Id.* at 2365. During the investigation, Dynamo agreed to two extensions of the statute of limitations on assessment. *Id.* In 2010, when the extended limitations period was about to expire, the IRS requested an additional extension, which Dynamo refused to grant. *Id.* The IRS then issued summonses to four individuals (the respondents) requesting information relevant to Dynamo's tax obligations. *Id.*

After Dynamo refused to comply with the summonses, the IRS initiated an enforcement proceeding in District Court to compel compliance with the summonses. *Id.* The respondents challenged the summonses on two grounds: (1) that the IRS issued the summonses in order to "punish" Dynamo for refusing to agree to a an additional extension of the limitations period and (2) that the IRS only chose to enforce the summonses to gain an unfair discovery advantage in Tax Court litigation. *Id.* at 2366. The respondents then sought permission to question the IRS agents who issued the summonses about their motives for doing so. *Id.*

The District Court denied the request, finding that "the respondents 'ha[d] made no meaningful allegations of improper purpose warranting examination of IRS agents.'" *Id.* (quoting App. to Pet. for Cert. 18a.). However, the Eleventh Circuit reversed, finding that the District Court had abused its discretion. *Id*. The Eleventh Circuit explained that under its precedents, "'an allegation of improper purpose is sufficient to trigger a limited adversary hearing where the taxpayer may question IRS officials concerning the Service's reasons for issuing the summons.'" United States v. Clarke, 517 Fed. Appx. 689, 691 (11th Cir. 2013) (quoting United States v. Southeast First National Bank of Miami Springs, 655 F.2d 661, 667 (5th Cir. 1981)). This approach conflicted with the approach of other circuits. *Clarke*, 134 S. Ct. at 2367.

On certiorari, the Supreme Court found that the standard applied by the Eleventh Circuit was incorrect because the Eleventh Circuit viewed "even bare allegations of improper purpose as entitling a summons objector to question IRS agents." *Id.* at 2368. In the Supreme Court's view, bare allegations do not suffice. The Court explained its approach as follows:

> The balance we have struck in prior cases comports with the following rule, applicable here: As part of the adversarial process concerning a summons's validity, the taxpayer is entitled to examine an IRS agent when he can point to specific facts or circumstances plausibly raising an inference of bad faith. Naked allegations of improper purpose are not enough: The taxpayer must offer some credible evidence supporting his charge. But circumstantial evidence can suffice to meet that burden; after all, direct evidence of another person's bad faith, at this threshold stage, will rarely if ever be available. And although bare assertion or conjecture is not enough, neither is a fleshed out case demanded: The taxpayer need only make a showing of facts that give rise to a plausible inference of improper motive. That standard will ensure inquiry where the facts and circumstances make inquiry appropriate, without turning every summons dispute into a fishing expedition for official wrongdoing. And the rule is little different from the one that *both* the respondents and the Government have recommended to us.

Id. However, the Court found that the respondents had introduced some evidence to support their assertions: "The respondents, for example, had submitted one declaration relating the timing of the summonses to Dynamo's refusal to extend the limitations period, . . . and another aiming to show that the IRS was using the summonses to obtain discovery it could not get in Tax

Court . . . ." (citations omitted). The Court therefore vacated the Eleventh Circuit's decision and remanded for consideration under the legal standard it had announced. *Id.* at 2369.

The Court of Appeals for the Eleventh Circuit then remanded the case to the District Court for the Southern District of Florida, which ruled in favor of the government. United States v. Clarke, 2015 U.S. Dist. LEXIS 33312 (S.D. Fla. 2015). That court found that the taxpayers' "submissions [did] not show facts giving rise to a plausible inference of improper motive regarding issuance of the summons." *Id.* at *7. The *Clarke* opinions are also discussed briefly in Chapter 11 of this Supplement.

How significant is the *Clarke* decision? A district court in the Fourth Circuit explained that *Clarke* did not constitute a change in the law:

> In fact, the Court granted certiorari in that case for the purpose of correcting the Eleventh Circuit, which had split from every other circuit to hold that "a bare allegation of improper motive entitles a person objecting to an IRS summons to examine the responsible officials." *Clarke,* 134 S. Ct. at 2367. Nothing in *Clarke* is the least bit inconsistent with the standard applied by the Fourth Circuit in *Conner v. United States*, 434 F.3d 676 (4th Cir. 2006) . . . .

United States v. Ali, No. PWG-13-3398, 2014 U.S. Dist. LEXIS 156548, at *10 (D. Md. Nov. 5, 2014).

In *Haw. Pac. Fin., Ltd. v. United States*, No. 13-00692, 2014 U.S. Dist. LEXIS 106405 *19–20 (D. Haw. Aug. 4, 2014), another post-*Clarke* decision, the court held that the summonsed individual was not entitled to receive an evidentiary hearing to explore the IRS's alleged improper purpose in issuing a summons. In that case, the company president claimed that an IRS agent threatened her with jail time if she refused to comply with a summons. *Id.* at *4. The court determined that the actions of a single agent were not dispositive and were not representative of the "'institutional posture' of the IRS." *Id.* at *14 (quoting LaSalle Nat'l Bank, 437 U.S. 298, 316 (1978)). Accordingly, the court granted the IRS's petition to enforce the summons. *Id.* at *19.

For commentary on how courts may treat summons enforcement in the post-*Clarke* era, see Amy S. Elliott, *DOJ Official Downplays Effect of* Clarke *on Summons Enforcement*, 145 TAX NOTES 28, 28 (2014) (reporting that Deborah Meland, a DOJ official, expressed her view that "the *Clarke* case 'doesn't change anything,'" while also reporting that practitioners believe "the new information document request (IDR) procedures put out by the IRS Large Business and International Division may prove helpful in convincing courts that an evidentiary hearing is warranted."). *See also* Andrew Velarde & Lee A. Sheppard, *Summons Evidentiary Hearing is "2-Way Street," DOJ Official Warns*, 146 TAX NOTES 736 (2015) (warning that "[t]axpayers and practitioners should be cautious when asking for an evidentiary hearing to prove that a summons was issued for an improper purpose" because "'[a]n evidentiary hearing is a two-way street. It is not simply the taxpayer's opportunity to question the agent.'") (quoting DOJ official Deborah Meland); Martin R. Press et al., Clarke*'s "Plausible Inference" Test (Can You Just Say No to an IRS Summons?),* J. TAX PRAC. & PROC., Oct.-Nov. 2014, at 31, 55 ("*Clarke* creates a new uniform factual standard of 'plausible inference.' It will be interesting to see how this factual standard is developed in future litigation."); Jasper L. Cummings, Jr., *Summons Enforcement and the Supreme Court*, 144 TAX NOTES 835 (2014) (discussing the *Clarke* decision and its implications).

§ 4.03[A][1] (The Attorney-Client Privilege)

The Tax Court recently addressed the question of whether the taxpayer's assertion of a "reasonable cause" defense to penalties waived the attorney-client privilege because it made "state of mind" an issue. *See* AD Inv. 2000 Fund LLC v. Comm'r, 142 T.C. 248 (2014). The court ruled in favor of the government, holding:

> Petitioners' averments in support of their affirmative defenses to respondent's determination of accuracy-related penalties put into contention the state of mind of those who acted for the partnerships and the partnerships' good-faith efforts to comply with the tax law. If petitioners persist in those defenses, it would be unfair to deprive respondent of knowledge of the contents of the opinions and the opportunity to put those opinions into evidence. If petitioners persist, they sacrifice the privilege to withhold the contents of the opinions.

Id. at 258. The court's holding may create a further incentive for the IRS to impose penalties strategically. *See* Tripp Baltz*, ABA Panelists: "Ad Investments 2000" Ruling Raises Queries on Waiver of Privilege,* DAILY TAX REP. (BNA), Sept. 22, 2014, at G-1.

§ 4.03[A][1][b] (What is "Legal" Advice?)

On the issue of what constitutes tax law advice protected either by the attorney-client privilege or the accountant-client privilege, see Claudine V. Pease-Wingenter, *Lemons from Lemonade: The Courts Fumble the FATP Privilege*, 129 TAX NOTES 977 (2010) (arguing that courts have misinterpreted Code section 7525, unnecessarily curtailing the scope of its protection). For a criticism of Pease-Wingenter's position, see Kip Dellinger, *The Statutory FATP Privilege*, 130 TAX NOTES 475 (2011).

§ 4.03[A][2] (The Work-Product Doctrine)

The text reproduces a portion of *United States v. Roxworthy*, 457 F.3d 590 (6th Cir. 2006), on pages 148–50. The IRS nonacquiesced in that case, AOD 2007-04, 2007 TAX NOTES TODAY 189-8 (Sept. 28, 2007). The IRS concluded, "The Service will continue to aggressively seek the enforcement of summonses, challenging unjustified assertions of the work product doctrine (and other privileges) in all appropriate cases, including those that would be appealable to the Sixth Circuit." *Id.*

Excerpts from the opinion of the District Court for the District of Rhode Island in the *Textron* case are included in two places in the third edition of the text. That case continued to be litigated after the casebook went to press. In a split decision, the Court of Appeals for the First Circuit affirmed the District Court's decision that Textron's tax accrual workpapers were privileged attorney work product, and remanded the case to the district court to determine whether Textron had waived the privilege when it shared its tax accrual workpapers with its outside auditor, Ernst & Young, LLP. United States v. Textron, Inc., 103 A.F.T.R. 2d 2009-509 (1st Cir. 2009). For critiques of that opinion, see Steve R. Johnson, *The Work Product Doctrine and Tax Accrual Workpapers*, 124 TAX NOTES 155 (2009); Lee A. Sheppard, *How Did the Government Lose* Textron*?*, 122 TAX NOTES 559 (2009); Dennis J. Ventry, Jr., Letter to the Editor, *Professor Blasts* Textron *Ruling*, 122 TAX NOTES 677 (2009).

The government petitioned the First Circuit for a rehearing *en banc*. The petition was granted, and the court vacated the panel decision. United States v. Textron, Inc., 577 F.3d 21, 26 (1st Cir. 2009). In its *en banc* decision, the majority framed the product privilege issue as whether a document that "is not in any way prepared 'for' litigation but relates to a subject that might or might not occasion litigation," should be privileged. *Id.* at 26. Unlike the panel, the *en banc* majority answered that question in the negative. *Id.* at 31–32. In so doing, the majority considered the role of tax reserves:

> [T]he IRS is unquestionably right that the immediate motive of Textron in preparing the tax accrual work papers was to fix the amount of the tax reserve on Textron's books and to obtain a clean financial opinion from its auditor. And Textron may be correct that unless the IRS might dispute an item in the return, no reserve for that item might be necessary, so perhaps some of the items might be litigated. But in saying that Textron wanted to be "adequately reserved," the district judge did not say that the work papers were prepared *for use* in possible litigation—only that the reserves would cover liabilities that might be determined in litigation.

Id. at 27.

On the issue of what constitutes privileged attorney work product, the majority explained:

> It is not enough to trigger work product protection that the *subject matter* of a document relates to a subject that might conceivably be litigated. . . . Nor is it enough that the materials were prepared by lawyers or represent legal thinking. . . . "[M]aterials assembled in the ordinary course of business, or pursuant to public requirements unrelated to litigation, or for other nonlitigation purposes are

> not under the qualified immunity [of Rule 26(b)(3) of the Federal Rules of Civil Procedure]."
>
> * * *
>
> Every lawyer who tries cases knows the touch and feel of materials prepared for a current or possible (*i.e.*, "in anticipation of") law suit. They are the very materials catalogued in *Hickman v. Taylor*. . . . No one with experience of lawsuits would talk about tax accrual work papers in those terms. A set of tax reserve figures, calculated for purposes of accurately stating a company's financial figures, has in ordinary parlance only that purpose: to support a financial statement and the independent audit of it.
>
> * * *
>
> In *Maine*, we said that work product protection does not extend to "documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation." *Maine v. United States Dep't of the Interior*, 298 F.3d 60, 70 (1st Cir. 2002) (quoting *United States v. Adlman*, 134 F.3d 1194, 1202 (2d Cir. 1998)) (internal quotation marks omitted). *Maine* applies straightforwardly to Textron's tax audit work papers which were prepared in the ordinary course of business—and it supports the IRS position.
>
> * * *
>
> [T]he only purpose of Textron's papers was to prepare financial statements.

Id. at 29–30.

The majority also held that "underlying prudential considerations squarely support the IRS' position," *id.* at 30, noting:

> [T]here [is not] present here the concern that *Hickman v. Taylor* stressed about discouraging sound preparation for a law suit. That danger may exist in other kinds of cases, but it cannot be present where, as here, there is in substance a legal obligation to prepare such papers: the tax audit work papers not only have a different purpose but *have* to be prepared by exchange-listed companies to comply with the securities laws and accounting principles for certified financial statements.

Id. at 31.

In a stinging dissent, Judge Torruella, joined by Judge Lipez, accused the majority of

> abandon[ing] [the First Circuit's] "because of" test, which asks whether "'in light of the nature of the document and the factual situation in the particular case, the document can be fairly said to have been prepared or obtained *because of* the prospect of litigation.'" *Maine v. United States Dep't of the Interior*, 298 F.3d 60, 68 (1st Cir. 2002) (emphasis in original) (quoting *United States v. Adlman*, 134 F.3d 1194, 1202 (2d Cir. 1998)). The majority purports to follow this test, but never even cites it. Rather, in its place, the majority imposes a "prepared for" test, asking if the documents were "prepared for use in possible litigation." Maj. Op. at 14. This test is an even narrower variant of the widely rejected "primary motivating purpose" test used in the Fifth Circuit and specifically repudiated by this court.

Id. at 32 (Torruella, J., dissenting).

The dissent urged the U.S. Supreme Court to "intervene and set the circuits straight on this issue which is essential to the daily practice of litigators across the country." *Id.* at 43. However, the Supreme Court denied Textron's petition for certiorari. Jeremiah Coder, *Supreme Court Denies Textron's Certiorari Petition*, 127 TAX NOTES 951 (2010); *see also* Textron Inc. v. United States, 560 U.S. 924 (2010).

For critique of the *en banc* opinion, see, *e.g.*, Ronald L. Buch, *The Touch and Feel of Work Product*, 124 TAX NOTES 915 (2009); Kathryn Keneally & Charles P. Rettig, Textron *and Work Product Immunity: A Misguided Decision*, J. TAX PRAC. & PROC., Oct.-Nov. 2009, at 15. For a narrower reading of the opinion, see Kenneth B. Clark, *A Different View of* Textron, 125 TAX NOTES 1197 (2009). For an analysis of the state of the law regarding application of the work product doctrine to dual purpose documents, such as tax accrual workpapers, which are "functionally used for business or regulatory purposes, but also contain legal analyses prepared because litigation is anticipated," see Joy A. Williamson, Note, *The Scope and Application of the Work Product Doctrine as Applied to Dual-Purpose Documents*, 30 VA. TAX REV. 715, 717 (2011).

Note that because the *en banc Textron* decision reversed the panel decision, finding that tax accrual workpapers are not protected from production by the attorney work product doctrine, the question of whether Textron had waived the work product privilege became moot. Therefore, the portion of the *Textron* District Court opinion addressing waiver of the work product privilege—reprinted on pages 151–53 of the text—should be viewed with caution. However, at least one scholar has argued that the District Court's discussion of attorney-client privilege was unaffected by the *en banc* opinion. *See* Claudine V. Pease-Wingenter, *Skating Too Close to the Edge: A Cautionary Tale for Tax Practitioners About the Hazards of Waiver*, 81 U. CIN. L. REV. 953, 980 (2013) ("[T]he First Circuit [en banc] vacated the District Court's judgment and held that the tax accrual workpapers were not within the scope of the work product doctrine because there [sic] were not prepared in anticipation of litigation. Nonetheless, because the District Court's holding on attorney-client privilege was not appealed, it was not disturbed by the First Circuit's subsequent opinion. Significantly, the District Court's precedent on attorney-client privilege is still good law." (footnotes omitted)).

United States v. Deloitte LLP, 610 F.3d 129 (D.C. Cir. 2010) also considered the question of whether audit workpapers (the "Deloitte Memorandum") were subject to protection as attorney work product. The court found that neither the fact that the memorandum was prepared by the outside auditor, Deloitte & Touche USA, LLP (Deloitte)—rather than its client, Dow Chemical Co.—nor the fact that "it was generated as part of the routine audit process, not in anticipation of litigation" necessarily meant that the memorandum could not constitute work product. *Id.* at 135. The court applied the "because of" test most circuits use,[11] *id.* at 137, but it nonetheless distinguished *Textron*, stating:

> *Textron*, which did apply the "because of" standard, is distinguishable because it turned on the court's examination of the particular documents at issue. While the court concluded that those documents were not work product, it did not exclude the possibility that other documents prepared during the audit process might warrant work-product protection. Moreover, Judge Torruella's dissenting opinion in *Textron* makes a strong argument that while the court said it was applying the "because of" test, it actually asked whether the documents were "prepared for use in possible litigation," a much more exacting standard.

Id. at 138 (citation omitted).

Despite its seemingly more expansive view of work product protection, the Court of Appeals concluded "that the district court lacked sufficient information to determine that the entire Deloitte Memorandum is work product." *Id.* at 135. It explained:

> According to the record, the document was created during Deloitte's preparation of an audit report which in Deloitte's view required consideration of potential litigation. The meeting generating the document included both Deloitte and Dow employees, as well as Dow's outside counsel. The document itself was prepared by a third party. While none of this negates the possibility of work-product privilege, it could make it likely that the document includes other information that is not work product. According to Dow's privilege log . . . , the memorandum does contain thoughts and analyses by legal counsel, but this does not rule out or

[11] *See, e.g.*, United States v. Richey, 632 F.3d 559, 568 (9th Cir. 2011) (explaining that "[d]ual purpose documents are deemed prepared *because of* litigation if 'in light of the nature of the document and the factual situation in the particular case, the document can be fairly said to have been prepared or obtained because of the prospect of litigation.'") (emphasis added) (citation omitted); Miller UK Ltd. v. Caterpillar, Inc., 2014 U.S. Dist. LEXIS 779 (N.D. Ill. Jan. 6, 2014) (applying the Seventh Circuit case of "*Binks Mfg. Co. v. National Presto Industries, Inc.* 709 F.2d 1109, 1119 (7th Cir.1983), which held that 'the test should be whether, in light of the nature of the document and the factual situation in the particular case, the document can fairly be said to have been prepared or obtained *because of* the prospect of litigation.' (emphasis in original)."); Evergreen Trading, LLC *ex rel.* Nussdorf v. United States, 80 Fed. Cl. 122, 132–33 (2007) (adopting the "because of" test as a straightforward and objective test that preserves confidentiality where it is appropriate).

> even render unlikely the possibility that it also includes other facts, other thoughts, other analyses by non-attorneys which may not be so intertwined with the legal analysis as to warrant protection under the work-product doctrine.

Id. at 138–39. Accordingly, the Court of Appeals remanded the case to the district court for an analysis of "whether the document was entirely work product, or whether a partial or redacted version of the document could have been disclosed." *Id.* at 139.

The Court of Appeals opinion in *Deloitte* also addressed a second question: The issue of first impression of whether Dow Chemical Co. waived the work product privilege when it disclosed documents to Deloitte, its independent auditor. *Id.* at 139-40. The Court of Appeals affirmed the District Court's finding that this disclosure did not constitute a waiver of the privilege. The court explained:

> Voluntary disclosure waives the attorney-client privilege because it is inconsistent with the confidential attorney-client relationship. [United States v. Am. Tel. & Tel. Co., 642 F.2d 1285, 1299 (D.C. Cir. 1980).] Voluntary disclosure does not necessarily waive work-product protection, however, because it does not necessarily undercut the adversary process. *Id.* Nevertheless, disclosing work product to a third party can waive protection if "such disclosure, under the circumstances, is inconsistent with the maintenance of secrecy from the disclosing party's adversary." *Rockwell Int'l Corp. v. U.S. Dep't of Justice*, 235 F.3d 598, 605, 344 U.S. App. D.C. 226 (D.C. Cir. 2001) (quoting *AT&T*, 642 F.2d at 1299). Under this standard, the voluntary disclosure of attorney work product to an adversary or a conduit to an adversary waives work-product protection for that material.
>
> Applying this standard, the government contends that Dow has waived work-product protection for the Dow Documents because Deloitte is (1) a potential adversary and (2) a conduit to other adversaries. We reject both contentions and conclude that Dow has not waived the protection.
>
> * * *
>
> Here, the question is not whether Deloitte could be Dow's adversary in any conceivable future litigation, but whether Deloitte could be Dow's adversary in the sort of litigation the Dow Documents address. We conclude that the answer must be no. In preparing the Dow Documents, Dow anticipated a dispute with the IRS, not a dispute with Deloitte. The documents, which concern the tax implications of [certain] partnerships, would not likely be relevant in any dispute Dow might have with Deloitte. Thus Deloitte cannot be considered a potential adversary with respect to the Dow Documents.

* * *

> The government also asserts that Deloitte is a conduit to Dow's adversaries. It claims the district court failed to address this question, but this ignores the district court's explicit statement that "no evidence suggests that it was unreasonable for Dow to expect Deloitte USA to maintain confidentiality." *Deloitte*, 623 F. Supp. 2d at 41. Like the district court, we conclude that Deloitte is not a conduit to Dow's adversaries.

Id. at 140–41.

For commentary on *Deloitte LLP*, see Jeremiah Coder, *Work Product Protection Stronger After* Deloitte, *Practitioners Say*, 129 TAX NOTES 9 (2010); Henry J. Lischer, Jr., *Work Product Immunity for Attorney-Created Tax Accrual Workpapers?: The Aftermath of* United States v. Textron, 10 FLA. TAX REV. 503 (2011). For a discussion of actions that can give rise to an express or implied waiver of privilege, see Pease-Wingenter, *Skating Too Close to the Edge*, *supra*.

In 2012, the Court of Federal Claims examined a work-product privilege claim for a taxpayer's tax reserve documents in connection with a structured trust advantaged repackaged securities (STARS) transaction. *See* Salem Fin., Inc. v. United States, 102 Fed. Cl. 793 (2012) (also discussed further below). The taxpayer argued that the documents contained "'[t]ax reserve information reflecting [its] analysis of the potential outcomes of litigation." *Id.* at 795 (alteration in original). The court declined to decide whether tax reserve documents are protected by the work-product privilege, holding that if the privilege applied, the taxpayer waived it by seeking the advice of its outside auditor, PwC, in order to have a defense against tax penalties. *Id.* at 797. The court similarly held that, by seeking KPMG's advice regarding unwinding the STARS transaction, the taxpayer had waived the application of the Federally Authorized Tax Practitioner (FATP) privilege to certain documents. *See id.* at 798. It explained:

> This Court has observed that because the tax practitioner privilege is "largely coterminous with the attorney-client privilege," waiver of the tax practitioner privilege occurs on the same terms as waiver of the attorney-client privilege. . . . Thus, like attorney-client privilege, where a party waives the tax practitioner privilege as to a particular communication, it also waives the privilege as to all communications involving the same subject matter.

Id. (citation omitted). For practice tips on protecting the application of the work-product privilege to tax-accrual workpapers in light of *Salem Financial, Inc.*, see Blaise M. Sonnier & Cherie J. Hennig, Salem Financial*: Work-Product Privilege Waived in Defending Against Tax Penalty*, TAXES, Jan. 2013, at 33, 33–34. For further reading, see Elliott Pisem & Jason K. Binder, *'STARS' Wars—The Service Strikes Back at Taxpayer Claims of Privilege*, 116 J. TAX'N 237 (2012).

In *Wells Fargo & Co. v. United States*, 2013 U.S. Dist. LEXIS 79814 (D. Minn. June 4, 2013), a federal district court held, in a lengthy opinion, that certain analyses in Wells Fargo's tax accrual workpapers were protected by the work-product privilege. *Id.* at *112. The court noted the limited reach of its holding:

> The fact that Wells Fargo's Tax Accounting Group created many of the TAWs [(tax accrual workpapers)] at issue does not alter the Court's decision. The recognition and measurement analysis in the TAWs reflects the legal thinking of Wells Fargo's attorneys on anticipated litigation and is therefore protected. . . . These attorneys' pre-existing thoughts, conclusions, and opinions about ongoing and likely litigation, later incorporated into the TAWs, are protected work product.
>
> The Court cautions that this ruling is limited to the unique circumstances of Wells Fargo, a company that has substantially limited the number of tax positions that it subjected to a FIN 48 analysis and specifically proved its anticipation of litigation with regard to each of its UTPs [(uncertain tax positions)] at the time it created its TAWs. The Court does not adopt Wells Fargo and amicus curiae's argument that all TAWs, by their very nature, are created "because of" litigation simply because the taxpayer must "assume" under FIN 48 that positions will be litigated. A hypothetical assumption that litigation will occur, even in cases where there might be little to no actual possibility of litigation, is not equivalent with anticipating litigation. . . . Nonetheless, the Court concludes, under these unique facts, that Wells Fargo's TAWs contain pre-existing legal judgments prepared in anticipation of litigation that are not discoverable.

Id. at *115–16 (citation omitted).

The *Wells Fargo* court further found disclosure of the workpapers to KPMG did not constitute a waiver, finding that waiver required an intentional disclosure made to an adversary and that KPMG was not an adversary to Wells Fargo. *Id.* at *120–21. However, the court did require disclosure of certain workpapers containing uncertain tax positions that it found were not prepared in anticipation of litigation, given the IRS's legitimate purpose in serving the summons. *Id.* at *78–79, *105–11.

Tax writer Lee Sheppard noted that "It's just a district court opinion, but it is a case of first impression, and neither side will appeal." Lee A. Sheppard, *The New Look of Taxpayer Privilege*, 140 TAX NOTES 1159, 1160 (2013). She added, "Practitioners are flummoxed by the *Wells Fargo* court's holdings that identification of uncertain tax positions is not protected, but recognition and measurement are. Aren't the tax accrual workpapers all one big unitary package, protected or not? The court finessed the issue by saying that uncertain tax positions are identified in the ordinary course of business." *Id.* at 1164.

With respect to waiver of privileges more generally, Congress added Federal Rule of Evidence 502 in 2008. The Rule governs disclosures in federal and state proceedings, the scope of waiver and proper treatment of inadvertent disclosures, and the controlling effect of court orders, party agreements, and the Rule itself. The IRS has explained the reasons for the adoption of the rule in part as follows:

> The stated objective for the adoption of Rule 502 is to alleviate some of the costs associated with electronic discovery and document production in litigation by reducing the risks associated with inadvertent production of material protected by the attorney-client privilege or the work product doctrine. If an attorney inadvertently discloses information protected by the attorney-client privilege or work product, the new rule creates a presumption for the return of the inadvertently disclosed information.
>
> * * *
>
> The drafters of new Rule 502 concluded that, under the prior rules, if a party inadvertently produced material there was a risk that a court would find a waiver, not only with respect to material that was inadvertently produced, but also all other material touching upon the same subject. As a result of this risk, lawyers spent significant amounts of time and money in complex litigation reviewing documents and electronic material for production to ensure that nothing protected from disclosure was inadvertently produced. Also of concern was the widespread perception that the costs associated with that type of review had risen dramatically in recent years because of the exponential growth in volume of electronically stored information subject to discovery.

IRS Chief Counsel Notice CC-2009-023 (Aug. 3, 2009), *available at* http://www.irs.gov/pub/irs-ccdm/cc-2009-023.pdf.

Federal Rule of Evidence 502 "allows parties to enter into agreements concerning the effect of disclosure in a Federal proceeding and allows a federal court to enter an order finding that, for the purpose of other litigation, disclosure in the proceeding before that court does not result in a waiver." *Id*. The Chief Counsel Notice provides guidance under the new rule. In part, it states:

> While Rule 502 is designed to deal with discovery when vast amounts of documents are transmitted and stored electronically, it also applies to those requests seeking only a handful of paper documents. Agreements, such as claw-back agreements (agreements regarding the disposition of inadvertently produced documents) and quick-peek agreements (agreements allowing the requesting party take a quick peek at documents without the producing party undertaking the time and expense in advance to review the entire population of documents), should be

> avoided.
>
> * * *
>
> There is a concern that these types of agreements will be sought even when documents are not privileged or protected in the first instance. If the information is not privileged or protected, the Service is entitled to receive this information without an agreement. The proper process for obtaining information from the taxpayer is to request the information and then require the taxpayer to prove that it is privileged or protected.

Id.

The Chief Counsel Notice concludes:

> Given the concerns and uncertainties regarding the application of Rule 502, as well as the potential impact on the Service's operations and federal tax litigation, any agreement regarding privilege claims and waivers of privilege or the application of Rule 502 must be pre-approved by the Associate Chief Counsel (Procedure & Administration).

Id.

For a recent case that discusses Federal Rule of Evidence 502 at some length in the context of litigation over the IRS's revocation of tax-exempt status under Code section 501(c)(3), see *Educ. Assistance Found. for the Descendants of Hungarian Immigrants in the Performing Arts, Inc., v. United States*, No. 11-1573 (RBW), 2014 U.S. Dist. LEXIS 40579 (D.D.C. Mar. 27, 2014). For a tax refund suit briefly discussing Rule 502, see *Principal Life Ins. Co. (PLIC) v. United States*, 2014 U.S. Claims LEXIS 349 *13 n.7 (Fed. Cl. May 9, 2014) (finding documents disclosed by the IRS in order to determine penalties at the administrative level irrelevant to the tax refund suit, which is a *de novo* proceeding). For a Sixth Circuit opinion addressing waiver of the attorney-client privilege and Rule 502, see *New Phoenix Sunrise Corp. v. Commissioner*, 408 F. App'x. 908 (6th Cir. 2010) (holding that the taxpayer's reasonable cause defense to penalties based on reliance on a tax opinion put the subject matter of the tax opinion in issue and waived the privilege).

The courts have also recently examined the implications of work-product doctrine in the context of documents prepared by tax advisors in anticipation of litigation. In *Schaeffler v. United States*, 22 F. Supp. 3d 319 (S.D.N.Y. 2014), the Schaeffler Group made a tender offer for Continental AG, and many more shareholders accepted the tender offer than the Schaeffler Group had anticipated. *Id.* at 323. As a result, the Schaeffler Group acquired a much larger interest in Continental AG than it had intended, and needed to engage in financial and corporate restructuring. *Id*. at 323–24. The Schaeffler Group retained Ernst and Young and Dentons for tax advice, and shared documents prepared by those entities with the banks that had funded its acquisition of Continental AG. *Id.* at 324. The IRS, after an audit, issued summonses to Ernst &

Young to compel production of the documents that were shared by the Schaeffler Group relating to the restructuring. *Id.* at 323, 327. The Schaeffler Group filed a motion to quash the petition on the ground that the documents constituted protected work product because they were prepared in anticipation of litigation. *Id.* at 334. The court denied the motion, finding:

> had Schaeffler's tax advisors been asked to opine on the legal implications of the transactions with the knowledge that an audit or litigation would not occur, they "would have" used the same methodology to render tax advice: that is, a close analysis of the relevant legal authorities to determine how various tax positions would be tested in the crucible of litigation.
>
> For these reasons, we find that the EY Tax Memo, as well as the related responsive documents, would have been produced in the same form irrespective of any concern about litigation. Accordingly, these documents are not protected from disclosure under the work product doctrine.

Id. at 340–41.

The *Schaeffler* case has been criticized as harmful to work-product protection for tax opinions. *See* Robin L. Greenhouse et al., *District Court Opinion Guts Work Product Protection for Tax Opinions*, 144 TAX NOTES 329, 334 (2014) ("In *Schaeffler*, by creating an elaborate hypothetical with no apparent basis in the record, the court's analysis effectively swallows the rule protecting dual purpose documents and as a result, prevents work product protection from extending to pre-transaction legal analyses of transactions with significant tax implications.") (footnote omitted). The taxpayer got at least interim relief, however, because the District Court "granted the taxpayer's motion to stay enforcement of the summons pending appeal to the Second Circuit." *Id.* at 329.

§ 4.03[A][3][a] (Kovel Agreements)

In *United States v. Richey*, 632 F.3d 559, 562 (9th Cir. 2011), the Peskys' attorney hired an appraiser to value a conservation easement the taxpayers' limited partnership gave to the Nature Conservancy. The Peskys claimed a charitable contribution deduction for the gift and attached the appraisal to their tax return. *Id.* at 562–63. The IRS issued a summons to Richey, the appraiser, in connection with an audit of the taxpayers' returns. *Id*. The District Court quashed the summons. *Id.* On appeal, the Ninth Circuit reversed and remanded to the District Court for an *in camera* review of the documents claimed to be protected by privilege. *Id.* at 568.

With respect to the attorney-client privilege claim, the Court of Appeals explained:

> The attorney-client privilege may extend to communications with third parties who have been engaged to assist the attorney in providing legal advice. If the advice sought is not legal advice, but, for example, accounting advice from an

accountant, then the privilege does not exist.

> Here, [the law firm] hired Richey, at least in part, "to provide valuation services" in the form of an appraisal for the Easement. . . .
>
> Richey prepared the appraisal as required by Treasury Regulation section 1.170A-13(c)(1), so that the Peskys could claim the charitable deduction sought for the value of the Easement. . . . Importantly, as part of the explanation for the methods and specific bases for the appraiser's opinion of value, the work file contained "supporting documentation concerning the data, reasoning, and analyses" for the appraisal report.
>
> Based on this record, any communication related to the preparation and drafting of the appraisal for submission to the IRS was not made for the purpose of providing legal advice, but, instead, for the purpose of determining the value of the Easement. Further, to the extent the files contain documents that were not communications, they are not protected by the attorney-client privilege.

Id. at 566–67 (footnote omitted) (citations omitted). The court reached a similar conclusion on the work product claim, finding that the District Court erred in holding that Richey's entire work file was prepared in anticipation of litigation. *Id.* at 568. For analysis of the *Richey* case and advice on how to protect privileged documents, see Will Mawer & Jack Karns, *The* Kovel *Rule: Extension of the Attorney-Client Privilege to Accountants and Other Professionals in Tax Cases*, 19 TRINITY L. REV. 1 (2013); Blaise M. Sonnier, *Establishing and Protecting Privilege for Communications and Work Product of Outside Consultants*, 114 J. TAX'N 360 (2011).

§ 4.03[A][3][b] (*Arthur Young* and the Section 7525 Privilege)

Code section 7525(b) provides an exception to the application of the FATP privilege for:

> any written communication which is—
>
> (1) between a federally authorized tax practitioner and—
>
> (A) any person,
> (B) any director, officer, employee, agent, or representative of the person, or
> (C) any other person holding a capital or profits interest in the person, and
>
> (2) in connection with the promotion of the direct or indirect participation of the person in any tax shelter (as defined in section 6662(d)(2)(C)(ii)

I.R.C. § 7525(b).

In a 2009 dispute over application of the FATP privilege, the Court of Appeals for the

Seventh Circuit was one of the first to interpret the tax shelter exception. *See* Valero Energy Corp. v. United States, 569 F.3d 626 (7th Cir. 2009). The court explained:

> The parties have plucked two different definitions of promotion out of the dictionary. Valero, seeking to narrow the application of the tax shelter exception, contends that promotion means the "active furtherance of sale of merchandise through advertising or other publicity." Valero takes it a step further and urges us to consider the tax practitioner's merchandise to be prepackaged, tax-shelter products. Since Arthur Anderson provided Valero with an individualized tax reduction plan, not a one-size-fits-all scheme, Valero contends that the documents are beyond the government's reach. The government, unsurprisingly, reads promotion more expansively to mean "furtherance" or "encouragement" and asks us to affirm the district court's decision to release the documents under the tax-shelter exception.

Id. at 632. The court disagreed with the taxpayer's narrow reading of the term "promotion," stating, "the language is broad and encompasses any plan or arrangement whose significant purpose is to avoid or evade federal taxes." *Id.* In affirming the District Court's holding that the tax shelter exception applied, the court noted, "The government's burden to overcome the privilege is relatively light—it need only show that there is some foundation in fact that a particular document falls within the tax-shelter exception." *Id.* at 634. For commentary on the *Valero* decision and an argument in favor of a narrower reading of the exception, see John O. Sawyko, Note, *The Tax Practitioner-Client Privilege:* Valero*'s Shortcomings and a Better Approach*, 64 TAX LAW. 519 (2011).

More recently, the Court of Federal Claims, in a case discussed above in connection with waiver of the work-product privilege, considered the application of the "tax shelter" exception. *See* Salem Fin., Inc. v. United States, 102 Fed. Cl. 793 (2012) (also discussed in the next Section). The taxpayer denied that the "STARS" transaction it invested in constituted a tax shelter and further denied that the six documents for which it claimed the FATP privilege were connected with the promotion of a tax shelter. *Id.* at 798. The court agreed with the taxpayer's interpretation of the word "promotion":

> Congress chose to exempt from protection communications in connection with the "promotion" of participation in a tax shelter; it did not choose to exempt communications in connection with the promotion *and implementation* of a tax shelter, as the Government seeks to do. Once [the taxpayer] entered into the STARS transaction, KPMG no longer needed to promote [its] participation: [the taxpayer] was already participating. Accordingly, the Court finds that KPMG communications following the closing of the STARS transaction in 2002 do not constitute "promotion" and consequently, do not fall within the exception to the tax practitioner privilege.

Id. However, as noted above in Section 4.03[A][2], the court went on to find that the taxpayer had waived the privilege by relying on KPMG's advice as a defense to penalties. *See id.*

In *Santander Holdings USA v. United States*, 2012 U.S. Dist. LEXIS 109148 (D. Mass. Aug. 6, 2012), the court ruled that while "reliance on an advice-of-counsel defense works as a waiver as to all privileged communications concerning the *same* subject matter," *id.* at *2 (emphasis added), advice about changes in the law or the eventual unwinding of a transaction constitute *different* subject matters. The court acknowledged that its ruling conflicted with the conclusion reached by the Court of Federal Claims in *Salem Financial*, but it found that "[i]dentifying the subject matter broadly as 'tax advice about the STARS transactions' is too general an assessment of the nature of the subject matter." *Id.* The court then observed: "Furthermore, the tax practitioner privilege arising under 26 U.S.C. § 7525 is not vitiated by the tax shelter exception. Assuming for this question that STARS constitutes a 'tax shelter,' which is essentially an ultimate question in this case, nonetheless the advice given by KPMG was not given in 'promotion' of the tax shelter, as required by § 7525(b)." *Id.* This latter observation seems consistent with *Salem Financial*.

For a practice-oriented overview of the FATP and waiver scenarios, see Christine S. Hooks, *Tax Talk: The Tax-Related Privilege You May Have Already Waived*, FED. LAW., Mar. 2013, at 23, *available at* http://presnellonprivileges.files.wordpress.com/2013/05/hooksarticle.pdf.

§ 4.03[B] (Court Review of Privilege Claims)

The Court of Federal Claims has used a "quick peek" procedure to help resolve the parties' dispute over whether certain documents withheld by the taxpayer contained legal advice. *See* Salem Fin., Inc. v. United States, 102 Fed. Cl. 793 (2012) (also discussed above in connection with waiver of the work-product privilege and the "tax shelter" exception to the FATP privilege). The court explained:

> During oral argument on January 4, 2012, counsel for Defendant suggested that the parties' dispute over the documents withheld under the attorney-client privilege could be resolved by using a "quick peek" procedure. . . . The Advisory Committee Notes accompanying Federal Rule of Civil Procedure 26 note that parties to a dispute may utilize a quick peek procedure to minimize the costs and delays associated with reviewing large amounts of documents to ensure that privileged communications are not disclosed inadvertently. . . . Although the context here is different, the Court finds that something akin to a quick peek procedure would be useful to resolve the parties' dispute, especially given the large number of challenged documents. During oral argument, counsel for Plaintiff stated that he would be amenable to using a quick peek procedure. . . .
>
> Accordingly, the Court directs counsel for the parties to meet in person at a mutually convenient time and place so that the Government may review the

> approximately 390 documents at issue. The Court anticipates that counsel for the Government will have an opportunity to review each document and designate those that it wishes Plaintiff to produce and those that it no longer seeks to compel. In providing the documents for the Government's review, Plaintiff does not waive any privilege or protection it has asserted previously in this case. Counsel for the parties may engage in discussions to attempt to reach agreement on disclosure or non-disclosure of the documents. If counsel desire to modify the above procedure in any respect, the Court is willing to consider reasonable alternative suggestions from the parties.

Id. at 799–800. "The court's decision to use a quick-peek process to reduce the number of documents it might have to review in an in camera inspection 'is certainly novel,' [tax attorney Robin] Greenhouse said. 'In allowing the parties to try to reach agreement over the characterization of documents as privileged without causing waiver of any applicable privilege, the court offers a potentially effective process for future privilege litigation,' she said." Jeremiah Coder, *Penalty Defense Waives Work Product Protection*, 134 TAX NOTES 509, 510 (2012).

Chapter 5

§ 5.02[A] (Timing Issues)

Revenue Procedure 2009-14, 2009-1 C.B. 324, which explains details of the pre-filing agreement program, supersedes Revenue Procedure 2007-17, mentioned in the text. The revisions are minor and do not affect the discussion in the text.

§ 5.02[B] (Options at the Conclusion of the Examination)

In 2012, the IRS announced that the 2008 expansion of its fast-track settlement (FTS) program for taxpayers in the Tax Exempt/Governmental Entities operating division would become permanent. *See* I.R.S. Announcement 2012-34, 2012-36 I.R.B. 334. With the assistance of an Appeals Officer, the entity and the examining agent can use the fast-track procedures to resolve both factual and legal issues before the issuance of a 30-day letter. *Id.*

The IRS has also extended its fast-track settlement program to all taxpayers in the Small Business/Self-Employed (SB/SE) Operating Division. *See* I.R.S. News Release IR-2013-88, *available at* http://www.irs.gov/uac/Newsroom/Fast-Track-Settlement-Program-Now-Available-Nationwide;-Time-Saving-Option-Helps-Small-Businesses-Under-Audit. Under this program, "taxpayers under examination with issues in dispute work directly with IRS representatives from SB/SE's Examination Division and Appeals to resolve those issues, with the Appeals representative typically serving as mediator." *Id.*

§ 5.02[C][1] (Background on the IRS Appeals Division)

In February 2012, the IRS released Revenue Procedure 2012-18, which supersedes Revenue Procedure 2000-43, discussed in the text, and updates rules regarding *ex parte* communications. Rev. Proc. 2012-18, 2012-1 C.B. 455. The 2012 procedure clarifies definitions and transmittal procedures and explains how the *ex parte* prohibition applies in CDP cases and alternative dispute resolution proceedings. Among the more important changes reflected in Revenue Procedure 2012-18 are rules regarding remedies available to taxpayers if Appeals Officers breach the *ex parte* communication prohibition. According to the procedure:

> The *ex parte* communication rules set forth in this revenue procedure do not create substantive rights affecting the taxpayer's tax liability or the IRS' ability to determine, assess, or collect that tax liability, including statutory interest and any penalties, if applicable. The IRS takes the *ex parte* communication rules seriously and will continue its efforts to ensure compliance through training and oversight. Most breaches of the *ex parte* communication rules may be cured by timely notifying the taxpayer/representative of the situation, sharing the communication or information in question, and affording the taxpayer/representative an opportunity to respond. Consequently, Appeals shall notify the taxpayer/representative of the breach and request input from the

> taxpayer/representative regarding the appropriate remedy for a breach of the *ex parte* communication rules. After considering the specific facts and discussing the matter with the taxpayer/representative, as appropriate, Appeals may determine that an additional remedy is warranted, including reassigning the case to a different Appeals/Settlement Officer who has had no prior involvement in the case. The specific administrative remedy, however, that may be made available in any particular case is within the sole discretion of Appeals. The deciding official for the determination of the appropriate remedy for a breach of the *ex parte* communication rules will be a second-level manager.

Id. at § 2.10.

More recently, the Chief of the IRS Appeals Division, Sheldon Kay, clarified how the Appeals Division will approach a violation of the *ex parte* communication rules. According to Kay, "if a violation occurs, the remedy will seek to put the taxpayer back in the position it would have been in had the violation not occurred. . . . often, the remedy is to simply allow the taxpayer to respond to the issue raised by the other party." Jaime Arora, *IRS Appeals Procedures Changing to Reflect More Judicial Approach*, 140 TAX NOTES 308–09 (2013). Kay warned, however, that an affected taxpayer does not "get a percentage discount off your taxes for each violation.'" *Id*. at 309.

As reflected in the earlier guidance, the *ex parte* prohibition does not apply to communications between Appeals Officers and Chief Counsel attorneys in docketed cases in Tax Court unless the case remains within Appeals' settlement jurisdiction. Otherwise:

> Appeals employees should not communicate *ex parte* regarding an issue in a case pending before them with a field attorney if the field attorney personally provided legal advice regarding the same issue in the same case to the originating function or personally served as an advocate for the originating function regarding the same issue in the same case. This restriction only applies while Appeals is performing its duties of evaluating the strengths and weaknesses of the specific issues in specific cases and the overall hazards of litigation for those cases. If an Appeals employee is not functioning in that capacity, for example, if an Appeals employee is preparing a statutory notice of deficiency, this restriction does not apply.

Id. at § 2.06. Revenue Procedure 2012-18 also confirms that Appeals Officers are not generally bound by the legal advice that they receive from the Chief Counsel attorneys. "The legal advice is but one factor that Appeals will take into account in its consideration of the case. Appeals employees independently evaluate the strengths and weaknesses of the specific issues in the cases assigned to them and make an independent judgment concerning the overall strengths and weaknesses of the cases they are reviewing and the hazards of litigation." *Id.* In response to the revised *ex parte* communication rules, the IRS Chief Counsel's office issued updated guidance for its attorneys. I.R.S. Chief Counsel Notice CC-2012-010, *available at* 2012 TAX NOTES TODAY 93-42 (May 14, 2012).

§ 5.02[C][3] (Docketed Versus Nondocketed Appeals)

In July of 2013, the IRS Appeals Office issued a memorandum to its employees that, among other matters, revises guidelines for when an IRS Appeals Officer should raise new issues that were not brought up during the audit. *See* Memorandum for Appeals Employees, Control No. AP-08-0713-03 (July 18, 2013). The memorandum implements the Appeals Judicial Approach and Culture Project ("AJAC"), which is designed to return Appeals "to a quasi-judicial approach in the way it handles cases, with the goal of enhancing internal and external customer perceptions of a fair, impartial and independent Office of Appeals." *Id.* The memorandum announces several revisions to the Internal Revenue Manual, including the following:

> **8.6.1.6.2**
>
> **General Guidelines**
>
> (1) Appeals will not raise new issues and will focus dispute resolution efforts on resolving the points of disagreement identified by the parties. The Appeals process is not a continuation or an extension of the examination process.
>
> (2) Appeals will attempt to settle a case on factual hazards when the case submitted by Compliance is not fully developed and the taxpayer has presented no new information or evidence.
>
> (3) In resolving disputes, Appeals may consider new theories and/or alternative legal arguments that support the parties' positions when evaluating the hazards of litigation in a case. However, the Appeals hearing officer will not develop evidence that is not in the case file to support the new theory or argument. . . .
>
> (4) The discussion of new or additional cases (or other authorities, e.g., revenue rulings or revenue procedures) that supports a theory or argument previously presented does not constitute consideration of a new issue.
>
> (5) In docketed cases, the Appeals hearing offer will consider a new issue affirmatively raised by the government in pleadings and may consider any new evidence developed by Compliance or Counsel to support the government's position on the new issue. The Appeals hearing officer's consideration of a new issue in a docketed case will take into account that the government has the burden of proof. . . .

Internal Revenue Manual 8.6.1.6.2 (Nov. 14, 2014). A "new issue" for purposes of the new policy includes "a matter not raised during Compliance's consideration" but does not include new issues raised by taxpayers. *See* Internal Revenue Manual 8.6.1.6.1 (June 25, 2015). Prior to this change, Appeals Officers were permitted to raise new issues if the ground for such action was a substantial one, and the potential effect upon the taxpayer's liability was material. *See* IRS Policy Statement P-8-2 (Jan. 5, 2007).

The IRS announced a second phase of the AJAC project in July of 2014. The overall objective of the Phase 2 revisions is to create a clearer delineation between the roles of Examination and Appeals divisions. *See* Memorandum for Appeals Employees, Control No. AP-08-0714-0004 (July 2, 2014), *available at* http://web.archive.org/web/20140912020827/http:/www.irs.gov/pub/foia/ig/spder/AP-08-0714-0004 REDACTED%5B1%5D.pdf. The Memorandum announces numerous revisions to the Internal Revenue Manual, affecting, among other matters, when the Appeals Officer should return cases to the Examination Division for further development. As a general matter, an Appeals Officer should not return a case to the examiner unless (1) the taxpayer's protest is missing, (2) the protest fails to set forth the taxpayer's position, or (3) for matters in excess of $25,000, the protest fails to satisfy the stated requirements in IRS Publication 5. *See* Internal Revenue Manual 8.2.1.5 (June 28, 2012). However, the Appeals Officer may reject or return the matter if the taxpayer has not consented to extend the statute of limitations on assessment and there are fewer than 365 remaining in the limitations period. Internal Revenue Manual 8.2.1.4(1) (June 28, 2012).

As noted above, guidelines discourage Appeals Officers from raising new issues. By contrast, if the taxpayer raises new issues at the Appeals stage, the Appeals Officer is instructed to return the case to the examiner to consider the new information and make a determination. Internal Revenue Manual 8.2.1.8.3 (June 28, 2012). According to the new guidance, "Appeals hearing officers are not investigators or examining officers and may not act as such. Therefore, Appeals hearing officers will not take investigative actions or perform analysis of new information or new issues." *Id*.

§ 5.02[C][4] (Statutory Provisions Affecting Appeals Consideration and Settlements)

The IRS Office of Chief Counsel has issued updated guidance to its field attorneys about how to process and evaluate qualified offers made by taxpayers pursuant to section 7430(g). I.R.S. Chief Counsel Notice CC-2010-007 (Apr. 2, 2010), *available at* http://www.irs.gov/pub/irs-ccdm/cc-2010-007.pdf. As noted in the text, one effect of the qualified offer rule is that it can eliminate the IRS's defense against the taxpayer's claim for administrative and litigation costs based on the argument that the IRS's position was substantially justified.

Chief Counsel Notice 2010-007 instructs IRS attorneys on how to evaluate whether a taxpayer is eligible to receive costs and fees if the offer is accepted or if the offer is determined not to be a qualified offer because it fails one of the five statutory requirements. According to the Notice:

> The qualified offer rule is intended to encourage settlement. Therefore, if the taxpayer makes a qualified offer and the Service settles the matter, either by accepting the offer or by other means, the qualified offer rule does not provide for an award of fees. A taxpayer who settles the matter or makes an offer that is not a qualified offer may still be able to obtain costs under the general provisions of section 7430. Under those provisions, to recover costs the taxpayer must prove that the taxpayer substantially prevailed as to the amount in controversy or with respect to the most significant issue or set of issues presented. Furthermore, the Service will not be liable for costs under section 7430 if it establishes that its position was substantially justified.

Id.

§ 5.02[C][5] (Negotiating a Settlement with Appeals)

An official with the IRS Appeals Division reported in 2011 that it takes, on average, around 251 days to close a case. According to the official, that number used to be "a lot higher." Liz White, *IRS Appeals Division Working on Process Improvements, Timeliness, Chief Says*, DAILY TAX REP. (BNA), Dec. 4, 2011, at G-3. The official also offered advice to practitioners to accelerate the settlement process: "Taxpayers can make sure they are prepared . . . . If new information is gathered, it should be sent to Compliance because Appeals does not find facts." *Id.*

§ 5.02[C][6] (Alternative Dispute Resolution)

The IRS has updated its Appeals mediation program to clarify and expand the types of cases that can be mediated. Revenue Procedure 2009-44, 2009-2 C.B. 438, supersedes Revenue Procedure 2002-44, mentioned in the text. As before, the parties can use mediation to resolve both factual and legal issues. Revenue Procedure 2009-44 now permits taxpayers to employ mediation in certain Offer in Compromise cases. The revenue procedure also spells out how mediators are selected, how mediation sessions should be conducted, and what terms the mediation agreement must contain. It also includes an updated model mediation report. IRS Announcement 2011-6, 2011-1 C.B. 433, modifies Revenue Procedure 2009-44 and specifies in more detail the types of Offer in Compromise cases suitable for mediation.

Chapter 6

§ 6.02[A] (Disclosure Under the Freedom of Information Act)

A recent district court case found the IRS's response to FOIA requests insufficient. *See* Sea Shepherd Conservation Soc'y v. IRS, No. 13-1422 (ABJ), 2015 U.S. Dist. LEXIS 41017, at *1–2 (D.D.C. Mar. 31, 2015). Sea Shepherd is a non-profit environmental group engaged in campaigns against the Institute of Cetacean Research, which was allegedly funded in part by the Japanese government. *Id.* at *2. Sea Shepherd saw in classified documents released online by Wikileaks that U.S. and Japanese government officials were discussing its non-profit status. *Id.* at *3. Sea Shepherd subsequently filed a FOIA request. *Id.* at *5. After the IRS missed a response deadline, Sea Shepherd filed suit to compel the IRS to turn over the requested documents. *Id.* at *6. The District Court found that the IRS's search for records was inadequate in several ways. *Id.* at *14–15. The court then remanded the case to the IRS to conduct an additional search, provide more detailed justifications for any claimed FOIA exemptions, and release "any reasonably segregable non-exempt material." *Id.* at *47.

In 2012, 2013, and 2014, TIGTA reviewed the IRS's compliance with FOIA. In 2012, TIGTA found that the IRS largely applied FOIA correctly. *TIGTA Finds IRS Mostly Adhered to FOIA Guidelines*, 2012 TAX NOTES TODAY 165-14 (Aug. 22, 2012). It found that the IRS may have improperly withheld information in only 2 of the 60 cases it examined, and failed to timely respond to requests in only one case. *Id.*

In TIGTA's 2013 review, it noted that there were cases of IRS noncompliance with FOIA. *TIGTA Notes Cases of IRS Noncompliance with FOIA Guidelines*, 2013 TAX NOTES TODAY 190-19 (Oct. 1, 2013). It found that the IRS may have improperly withheld information or failed to search sufficiently for information in nine of the 55 FOIA/Privacy Act information requests that it examined. *Id.* In addition, the IRS may have violated taxpayer rights by failing "to adequately search for and provide information" in three of 54 sampled Code section 6103 information requests. *Id.* Furthermore, the IRS inadvertently disclosed sensitive taxpayer information in responding to nine of 55 FOIA/Privacy Act information requests and four of the 54 section 6103 information requests. *Id.* The IRS also failed to respond to fifteen of the 54 section 6103 requests for more than 30 calendar days. *Id.*

Accordingly, TIGTA recommended that the IRS: "1) require disclosure specialists to adhere to the general correspondence guidelines when processing I.R.C. section 6103 requests by specifying these time frames in the Disclosure section of the Internal Revenue Manual; and 2) emphasize the importance of disclosure laws and regulations with disclosure specialists and their managers." *Id.* The IRS agreed with these recommendations. *Id.*

In 2014, TIGTA found that the IRS timely responded to FOIA requests, but in some cases it failed to meet disclosure requirements or disclosed sensitive taxpayer information. *TIGTA Reviews IRS Fiscal 2014 Information Disclosure Compliance*, 2014 TAX NOTES TODAY 192-15 (Oct. 3, 2014). It found that of the sixty-two FOIA/Privacy Act information requests that it examined, the IRS improperly withheld information or failed to search sufficiently for information in seven, and the IRS inadvertently disclosed sensitive taxpayer information in responding to thirteen of those requests. *Id.* The IRS may have also violated taxpayer rights by failing to "adequately search for and provide information" in eight of fifty-three Code section 6103 information requests. *Id.* Furthermore, the IRS inadvertently disclosed sensitive taxpayer information in responding to one of those requests. *Id.* The IRS responded to all FOIA/Privacy Act requests in a timely manner. *Id.* The report made no specific recommendations other than referring to the recommendations in the 2013 report, which the IRS had agreed to. *Id.* For criticism of the IRS's inadvertent release of sensitive taxpayer information, see William Hoffman, *IRS Knocked for Releasing Sensitive Info in FOIA Responses*, 145 TAX NOTES 48 (2014).

A conservative watchdog group, Cause of Action, reportedly believes that TIGTA is applying Code section 6103 overly broadly, to shield the White House. *See* Diane Freda, *TIGTA Uses Privacy Protection Law To Shield IRS Officials, Group Argues*, DAILY TAX REP. (BNA), Dec. 17, 2014, at G-7. In *Cause of Action v. Treasury Inspector General for Tax Administration*, No. 13-1225 (ABJ), 2014 U.S. Dist. LEXIS 140595 (D.D.C. Sept. 29, 2014), the District Court for the District of Columbia held that TIGTA had improperly responded to the 2012 FOIA request of Cause of Action, a non-profit organization. Cause of Action requested "'[a]ll documents . . . pertaining to any investigation by [TIGTA] into the unauthorized disclosure of [26 U.S.C.] § 6103 'return information' to anyone in the Executive Office of the President.'" *Id.* at *1–2 (quoting Ex. 1 to Compl. At 2) (alterations in original). TIGTA had responded to the FOIA request with a so-called "Glomar" response, informing Cause of Action that it could neither admit nor deny the existence of any relevant records. *Id.* at *2. Cause of Action filed a complaint and moved for summary judgment on the ground that TIGTA's Glomar response was improper. *Id.* at *3. The District Court explained:

> A Glomar response "is proper if the fact of the existence or nonexistence of agency records falls within a FOIA exemption." Wolf [v. CIA], 473 F.3d [370] at 374 [(D.C. Cir. 2007)]. To justify this response, an agency must explain why it can neither confirm nor deny the existence of responsive records. *See* Phillippi v. CIA, 546 F.2d 1009, 1013 . . . (D.C. Cir. 1976) ("Adapting these procedures to the present case would require the Agency to provide a public affidavit explaining in as much detail as is possible the basis for its claim that it can be required neither to confirm nor to deny the existence of the requested records."). This inquiry is not based on the content of the documents, but on whether the potential harm caused by revealing the mere existence of the documents is protected by a FOIA exemption. . . .

Id. at *4–5. Accordingly, the court granted Cause of Action's motion for summary judgment and remanded the case to TIGTA for further action. *Id.* at *25–26.

In December 2014, TIGTA issued a letter stating that 2,043 pages of documents were responsive to Cause of Action's request, but that none could be disclosed because they contained protected return information. *TIGTA Says Documents in FOIA Request Will Be Withheld*, 2014 TAX NOTES TODAY 233-20 (Dec. 4, 2014). TIGTA also identified 466 additional pages it would examine to determine if they were responsive to Cause of Action's request. *Id.* Cause of Action reportedly believes that TIGTA is interpreting section 6103 too broadly. *See* Freda, *supra.*

For further reading about FOIA requests in the tax context, see, *e.g.*, Frank Agostino & Tara Krieger, *Open(ing) Agency Action to the Light of Public Scrutiny-Using FOIA Requests*, J. TAX PRAC. & PROC., Aug.-Sep. 2013, at 35, 35–42; Larry Jones, *Examination: Freedom of Information Act-What Does the IRS Have In Its Files?*, J. TAX PRAC. & PROC., June-July 2013, at 5, 5–8.

§ 6.02[C] (Access to Written Determinations Under Section 6110)

The IRS has released its 2014 annual report on emailed Chief Counsel Advice. In 2014, the IRS disclosed 98 emails, while withholding 3,137 as privileged based on FOIA exemptions and 354 more on other grounds. *IRS Generated 2,000 Fewer E-Mailed CCAs in 2014, Disclosed 98*, 2015 TAX NOTES TODAY 62-23 (Apr. 1, 2015). In addition, the IRS has provided guidance to Chief Counsel attorneys on redacting information from field advice reviewed by the National Office and made available to the public under a court order relating to legal advice memoranda. I.R.S., Chief Counsel Notice 2014009 (Sept. 22, 2014), *available at* http://www.irs.gov/pub/irs-ccdm/cc%202014%20009.pdf.

In *Anonymous v. Commissioner*, 134 T.C. 13 (2010), the Tax Court ruled that it did not have jurisdiction to prevent the IRS from disclosing a taxpayer's adverse private letter ruling. According to the Tax Court, the APA and section 6110 do not authorize the court to prevent public disclosure of a letter ruling in its entirely. Moreover, the Tax Court found that, under section 6103(h)(1), it did not have the authority to restrain the Commissioner from disclosing the ruling to Department of the Treasury officers and employees. *Id.* at 19. Instead, the Tax Court's authority is limited to determining what information in the ruling should be deleted and what should remain open for public inspection. *Id.*; *see also* I.R.C. § 6110(f)(3)(A).

§ 6.03 (PRESERVING TAXPAYER CONFIDENTIALITY: CODE SECTION 6103)

In 2012, the Court of Appeals for the Federal Circuit held, in a case of first impression, that the Court of Federal Claims did not have the authority to compel disclosure of confidential non-party return information under section 6103(h)(4)(B). In re United States, 669 F.3d 1333 (Fed. Cir. 2012). In that case, Panasonic Communications Corporation of America ("Panasonic") paid an excise tax for importing products containing ozone-depleting chemicals (ODCs). *Id.* at 1334. It filed suit seeking a refund, alleging flaws in the gas chromatography test performed by the government to check for ODCs. *Id.* The United States Court of Federal Claims ruled that the government had to turn over the tests and similar information of non-party entities, in order to help determine the reliability of the methodology. *Id.*

In granting a petition for a writ of mandamus, the Federal Circuit held that the Court of Federal Claims could not order the government to turn over the results of the non-parties' tests because the information was not "directly related" to the resolution of an issue in the proceeding within the meaning of Code section 6103(h)(4)(B). *Id.* at 1337, 1340. *See also* Jeremiah Coder, *Federal Circuit Clarifies Third-Party Return Information Disclosure Exception*, 2012 TAX NOTES TODAY 15-4 (Jan 23, 2012).

The IRS has come under fire for alleged mistreatment of some exempt organizations. During 2013, the IRS was accused of systematic mistreatment of certain conservative organizations that applied for determinations of tax-exempt status under Code section 501(c)(4), which includes "[c]ivic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare." *See Lawmakers Disagree on Steps to Address EO Issues Underlying IRS Scandal*, 2013 TAX NOTES TODAY 101-5 (May 24, 2013). That and the 2013 investigation of IRS conference expenditures are discussed further in Section 1.02 of this Supplement. Most relevant to this chapter, the IRS has also faced allegations of improper disclosure of the return information of certain tax-exempt organizations.

> ProPublica, an online investigative journalism outlet, in December published the pending application for tax-exempt status of social welfare group Crossroads GPS and in January posted to its website the applications of five more organizations. Last year, *The Huffington Post* and the Human Rights Campaign published the Schedule B donor list of the National Organization for Marriage (NOM), and *The Texas Observer* published the Schedule B of the Texas Public Policy Foundation, claiming the donor list was inadvertently posted on Guidestar.org. . . .
>
> ProPublica likely got the pending exemption applications as a result of breakdowns in the disclosure screening process, [Marcus] Owens ["a former EO director in the IRS Tax-Exempt and Government Entities Division and now an attorney with Caplin & Drysdale"] said. Reorganizations and consolidations in the IRS Disclosure Office have probably caused understaffing, he said, adding, "It's not surprising to me that errors have occurred."
>
> ProPublica President Richard Tofel said his organization obtained the applications from the IRS through a standing public records request and that when ProPublica received the applications, it asked whether that meant the organizations had been granted exempt status. The IRS then asked for the documents to be returned and not published. Tofel said ProPublica declined both requests. . . .

Practitioners Concerned About Confidentiality of EO Tax Data, 2013 TAX NOTES TODAY 28-3 (Feb. 11, 2013).

ProPublica's disclosures resulted in litigation. In October 2013, NOM filed a complaint in U.S. district court seeking damages for the IRS's alleged wrongful inspection and disclosure of its confidential tax return information. *Marriage Group Files Suit Against IRS For Unlawful Disclosure of Return Information*, 2013 TAX NOTES TODAY 193-7 (Oct. 4, 2013). NOM is a section 501(c)(4) organization that opposes same-sex marriage. *Id.* In its complaint, NOM alleged that the IRS disclosed confidential return information, including the names and addresses of its donors, to a gay rights advocacy group, the Human Rights Campaign. *Id.* The Human Rights Campaign allegedly published the information on its website and shared it with the Huffington Post. *Id.* NOM filed a complaint seeking actual and punitive damages. *Id.*

In June 2014, the District Court for the Eastern District of Virginia heard the IRS's motion for summary judgment. It found that a particular IRS employee, in responding to an inquiry for a copy of NOM's publicly available Form 990 returns, failed to redact the donor information attached to the return. The National Organization for Marriage, Inc. v. U.S., No. 1:13-cv-01225 (June 3, 2014), *available at* 2014 TAX NOTES TODAY 109-15 (June 6, 2014). It further found that that employee was not aware of either NOM's mission or that of the Human Rights Campaign, nor had she heard of the requester, who had identified himself as a member of the press. *Id.* The court therefore found that the disclosure was negligent but not grossly negligent or willful, and therefore did not warrant an award of punitive damages. *Id.* The court further found that there was no unlawful inspection of NOM's return information. *Id.*

By contrast, the court denied the IRS's summary judgment motion for NOM's claimed actual damages of $58,586.37 ($12,500 in attorneys' fees spent defending an election law suit resulting from claims that were at least partly based on the disclosed donor list, and $46,086.37 in attorneys' fees NOM spent to try to determine the source of the disclosure and prevent further circulation of its donor list). *Id.* The court also refused to grant summary judgment on the issue the IRS raised that NOM should be barred from recovering any damages because NOM failed to mitigate damages by offsetting against its claimed damages more than $75,000 in donations from new donors following the disclosure. *Id.* Following the District Court's decision, the IRS settled with NOM for $50,000. *See* Mackenzie Weinger, *IRS Pays $50K to Anti-Gay Marriage Group*, POLITICO (June 24, 2014), http://www.politico.com/story/2014/06/irs-nom-lawsuit-108266.html.

NOM then sought attorney's fees from the IRS under Code section 7430. In *National Organization for Marriage, Inc. v. United States*, No. 1:13cv1225 (JCC/IDD), 2014 U.S. Dist. LEXIS 147490 (E.D. Va. Oct. 16, 2014), the District Court for the Eastern District of Virginia denied NOM's claim for attorney's fees because the organization did not "substantially prevail" on the merits of its claim against the IRS and because the IRS's position in the case was "substantially justified." *Id.* at *5, 15–16. (Taxpayer actions for attorney's fees under Section 7430 are discussed in Chapter 11.)

At least one other court has allowed a claim against the IRS for wrongfully disclosing exempt organizations' application materials to ProPublica to proceed. *See* Citizen Awareness Project, Inc. v. IRS, No. 13-cv-2127-WJM-NYW, 2015 U.S. Dist. LEXIS 59355 (D. Colo. May 6, 2015). That case is discussed further below in Section 6.03[C] of this Supplement. For an excellent discussion of confidentiality protections applicable to exempt organizations and an argument for increased disclosure of the application materials of these organizations, see George K. Yin, *Reforming (And Saving) the IRS by Respecting the Public's Right to Know*, 100 VA. L. REV. 1115 (2014).

The IRS has considered other disclosure and confidentiality issues recently. First, the IRS determined in emailed advice that Code section 6103 and FOIA preclude disclosing to third parties executed settlement agreements because the agreements contain return information. *IRS Can't Disclose Settlement Agreements Made With Third Parties*, 2015 TAX NOTES TODAY 70-49 (Apr. 13, 2015). Absent consent from the third party whom the information is about, the requesting party must have a relationship with the third party covered in section 6103, such as a corporate officer. *Id.*

In addition, in a Program Manager Technical Assistance memorandum, the IRS considered whether its Return Preparer Office can disclose to a state regulatory agency records pertaining to return preparers. *IRS Considers Disclosure of Return Preparer Records*, 2015 TAX NOTES TODAY 92-19 (May 13, 2015). The memorandum concluded that a tax preparer's identifying number (PTIN), is not "taxpayer identity information" and thus does not constitute return information. *Id.* It was also not protected by the Privacy Act. However, the IRS found that information regarding pre-*Loving* return-preparer exam information is subject to the Privacy Act and "may not be disclosed absent permission from the individuals to whom the records pertain or a statutory exemption." *Id.*

The Joint Committee on Taxation (JCT) has proposed a bill to allow "information on the status of investigations of individuals whose returns or return information have been disclosed" to be released. *JCT Describes Bill to Allow Release of Investigation Information*, 2015 TAX NOTES TODAY 57-25 (Mar. 25, 2015). The proposed bill, H.R. 1026 (Taxpayer Knowledge of IRS Investigations Act), would amend Code section 6103(e) to allow the IRS to disclose to the complainant (or designee) whether an investigation has begun, is currently open, or has been concluded, based on the complainant's provision of information indicating any violations under Code sections 7213, 7213A, or 7214. *Id.* The bill would also allow the IRS to disclose whether any action has been taken with regard to the violation, including whether a referral for prosecution has been made. *Id.*

For further reading on the federal rules on the confidentiality of tax return information and the policy considerations that support that confidentiality, such as promoting tax compliance by allowing the IRS to strategically publicize its enforcement activities, see Joshua D. Blank, *United States National Report on Tax Privacy*, NYU School of Law Public Law Research Paper No. 13-76 (2013), *available at* http://ssrn.com/abstract=2348668; Joshua D. Blank, *In Defense of Individual Tax Privacy*, 61 EMORY L.J. 265 (2011).

§ 6.03[B] (Exceptions Under Section 6103 Permitting Disclosure)

The IRS has released Publication 1075, *Tax Information Security Guidelines for Federal, State, and Local Agencies: Safeguards for Protecting Federal Tax Returns and Return*

Information, *available at* http://www.irs.gov/pub/irs-pdf/p1075.pdf. This publication, effective January 1, 2014, provides guidance to government agencies who receive confidential return information from the IRS on how to protect that information. *See IRS Releases Publication on Protecting Federal Tax Return Information*, 2013 TAX NOTES TODAY 236-70 (Dec. 9, 2013).

The JCT issued a report providing data on the IRS's disclosures of return information under Code section 6103 to federal agencies, Congress, and state and foreign governments in 2014. *JCT Reports on IRS Return Disclosure Data for 2014*, 2015 TAX NOTES TODAY 109-48 (June 8, 2015). The IRS made 9.6 billion disclosures in 2014, which included 7.9 billion to state governments, 64.6 million to congressional committees, and 55.8 million concerning the Affordable Care Act. *Id.*

U.S. Senator Kelly Ayotte recently sent a letter to the IRS Commissioner, John Koskinen, regarding the IRS's refusal to provide identity theft victims with copies of any fraudulent tax returns filed in their names. *IRS Return Disclosure Policy Is Troubling, Ayotte Says*, 2015 TAX NOTES TODAY 105-29 (June 2, 2015). Citing Chief Counsel guidance from January 2012 stating that "'[under] I.R.C. section 6103(e)(7), an identity theft victim may obtain from the Service a copy of the 'bad return' and other return information associated with the processing of the 'bad return' filed by the alleged identity thief,'" *id.* (quoting I.R.S., C.C.A. 201246033 (July 12, 2012)), the letter asks the Commissioner to respond to several questions, including stating any changes that have been made since the 2012 guidance that would preclude the IRS from disclosure fraudulent returns to victims. *Id.*

For a proposal to reduce the privacy restrictions contained in Code section 6103, in order to provide a sample set of taxpayer returns for researchers to analyze, see Donald Morris, *Tax Privacy, Tax Complexity, and Tax Reform*, 143 TAX NOTES 697, 697 (2014) (arguing that the restrictions of Code section 6103 are an obstacle "to empirically based tax reform."

§ 6.03[C] (Remedies for Unlawful Disclosure Under Section 6103)

A district court has allowed a nonprofit group to proceed with its damages action stemming out of the ProPublica disclosure discussed above, in Section 6.03. *See* Citizen Awareness Project, Inc. v. IRS, No. 13-cv-2127-WJM-NYW, 2015 U.S. Dist. LEXIS 59355 (D. Colo. May 6, 2015). Citizen Awareness Project (CAP) submitted IRS Form 1024 to be recognized as a 501(c)(4) organization. *Id.* at *4. Failing to recognize that CAP's application was still pending, an IRS employee released CAP's Form 1024 to ProPublica. *Id.* at *6. ProPublica never published CAP's Form 1024 but did mention CAP in one article. *Id.* at *8. At trial, the IRS admitted liability for disclosing the confidential tax information in violation of section 7431(a)(1), but disputed the calculation of damages. *Id.* at *9. After making detailed findings regarding CAP's damage claims, the district court held that CAP could argue for actual damages of up to $4,819.78. *Id.* at *30–31. The court denied CAP's request for punitive damages because it failed to demonstrate that the IRS employee's actions were grossly negligent. *Id.* at *36.

Chapter 7

§ 7.02[A] (Summary Assessments)

The National Taxpayer Advocate has expressed concern about increasing usage of the math error exception. *See* 1 Nat'l Taxpayer Advocate, ANNUAL REPORT TO CONGRESS at 74–92 (2011) (discussing this as Most Serious Problem number 4), *available at* http://www.taxpayeradvocate.irs.gov//userfiles/file/IRS%20TAS%20ARC%202011%20VOL%201.pdf. As the Press Release accompanying that report stated:

> In 2010, the IRS issued notices correcting 10.6 million "math errors," up from four million in 2005. . . . The report notes that math error authority is increasingly used where there is disagreement over a facts-and-circumstances issue. The report says that math error notices are often vague and do not state the perceived error with specificity, making it difficult, if not impossible, for affected taxpayers to determine what has changed on their returns and whether to accept or contest the adjustments. . . . IRS math error notices also are sometimes inaccurate. . . . Of the 184,000 corrected math errors, a Taxpayer Advocate Service (TAS) sample showed the IRS had internal data to immediately resolve 56 percent of these reversals, and thus could have avoided denying eligible taxpayers their dependency exemptions and related tax credits and refunds.

Press Release, IRS, National Taxpayer Advocate Delivers Annual Report to Congress; Focuses on IRS Funding and Taxpayer Rights (Jan. 11, 2012), *available at* http://www.irs.gov/uac/National-Taxpayer-Advocate-Delivers-Annual-Report-to-Congress;-Focuses-on-IRS-Funding-and-Taxpayer-Rights. For further analysis of the exception, see William D. Elliott, *The Math or Clerical Error Exception*, J. TAX PRAC. & PROC., June-July 2011, at 25.

In an IRS oversight hearing, the Treasury Inspector General for Tax Administration, Russell George, similarly stated that "the majority of erroneous claims the IRS identifies do not contain the types of errors for which it has math error authority." *Oversight Hearing – Internal Revenue Service: Hearing Before the Committee on Appropriations Subcommittee on Financial Services and General Government*, 114th Cong. 13 (2015) (testimony of the Honorable J. Russell George, Treasury Inspector General for Tax Administration), *available at* http://www.treasury.gov/tigta/congress/congress_02252015.pdf. Mr. George noted that the Department of Treasury has made proposals for the IRS to obtain "correctable error authority" as part of the IRS's budget requests since 2013. *Id.*

The White House budget proposal for 2015 called for "greater flexibility" for IRS to address correctable errors. The proposal, if enacted, would replace specific grants of math error authority with a simple definition of math errors as computational or tabular mistakes, but would also create a new category of correctable errors. "Under this new category, the Department of the Treasury would have regulatory authority to permit the IRS to correct errors in cases where (1) the information provided by the taxpayer does not match the information contained in government databases, (2) the taxpayer has exceeded the lifetime limit for claiming a deduction or credit, or (3) the taxpayer has failed to include with his or her return documentation that is required by statute." Office of Mgmt. & Budget, Exec. Office of the President of the U.S., *Fiscal Year 2015 Analytical Perspectives: Budget of the U.S. Government* 172 (2014), *available at* http://www.whitehouse.gov/sites/default/files/omb/budget/fy2015/assets/spec.pdf.

§ 7.03 [B] (Return Filing Date)

The IRS recently updated the list of private delivery services under section 7502. *See* IRS Notice 2015-38; 2015-21 I.R.B. 1 (May 6, 2015), *available at* http://www.irs.gov/pub/irs-drop/n-15-38.pdf. The impact of using a private delivery service that is not designated under Section 7502 is discussed in Section 8.03[B] of this Supplement.

§ 7.03[C][2] (Substantial Omission of Items)

The Treasury Department recently finalized regulations interpreting Code section 6501(c)(10), regarding an extension of time to assess taxes where the taxpayer fails to report "listed" (potentially abusive) transactions. *See* I.R.C. §§ 6707A(c)(2); 6011. The final regulations clarify that the statute of limitations remains open for at least three years, and can remain open longer if the taxpayer or its advisor fails to provide the requisite information to the IRS. Treas. Reg. § 301.6501(c)-1(g). The taxpayer is required to complete Form 8886, "Reportable Transaction Disclosure Statement," and indicate that the form is being submitted to disclose reportable transactions under Code section 6501(c)(10). Treas. Reg. § 301.6501(c)-1(g)(5). If the IRS receives such a disclosure, the statute of limitations on assessment does not expire until one year from the date of the disclosure. Treas. Reg. § 301.6501(c)-1(g).

In 2010, the six-year limitation period for "substantial omission of items" of section 6501(e) was amended to apply where the omitted amount:

> (I) is attributable to one or more assets with respect to which information is required to be reported under section 6038D (or would be so required if such section were applied without regard to the dollar threshold specified in subsection (a) thereof and without regard to any exceptions provided pursuant to subsection (h)(1) thereof), and (II) is in excess of $5,000.

I.R.C. § 6501(e)(1)(A)(ii). The provision applies to "all returns as long as the period of time (determined without regard to the section 6501(e) amendments referenced above) for assessment of taxes has not expired as of March 18, 2010." *IRS Issues SB/SE Guidance on Changes to Limitations on Assessment and Collection*, 2012 TAX NOTES TODAY 62-55 (Mar. 30, 2012).

> In addition, section 6501(c)(8) was amended to clarify that this statutory exception to the period of time for assessment, if applicable, applies to the entire return, not just those tax liabilities associated with the information not reported.

> If, however, the failure to furnish information required to be reported is due to reasonable cause and not willful neglect, the section 6501(c)(8) extended time for assessment applies only to the item or items associated with such failure."

Id.

Whether a taxpayer's overstatement of basis in business-use property that the taxpayer disposed of constitutes a "substantial omission of items" for purposes of section 6501(e) was a hotly contested issue until the U.S. Supreme Court resolved it in the negative in *United States v. Home Concrete & Supply, LLC*, 132 S. Ct. 1836 (2012). In a divided opinion, the Court held that "*Colony* has already interpreted the statute, and there is no longer any different construction that is consistent with *Colony* and available for adoption by the agency." *Id.* at 1843.

As indicated in Chapter 2 of this Supplement, the government had raised the statute of limitations issue in a number of cases involving overstatement of basis in tax shelter transactions. In 2009, the government lost on this issue in two federal circuits. *See* Salman Ranch Ltd. v. United States, 573 F.3d 1362 (Fed. Cir. 2009) and Bakersfield Energy Partners v. Comm'r, 568 F.3d 767 (9th Cir. 2009) (affirming the Tax Court decision cited on page 266 of the text).

As discussed above, the Treasury Department then promulgated proposed and temporary regulations that provide in part that "an understated amount of gross income resulting from an overstatement of unrecovered cost or other basis constitutes an omission from gross income for purposes of section 6501(e)(1)(A) [or section 6229(c)(2)]." Temp. Treas. Reg. § 301.6501(e)-1T (Sept. 28, 2009); Temp. Treas. Reg. § 301.6229(c)(2)-1T (Sept. 28, 2009). The effective date of the regulations was "taxable years with respect to which the applicable period for assessing tax did not expire before September 24, 2009." *See, e.g.*, Temp. Treas. Reg. § 301.6501(e)-1T(b). The temporary regulations under sections 6229 and 6501 were finalized on December 14, 2010. *See* Definition of Omission from Gross Income, 75 Fed. Reg. 78,897 (Dec. 17, 2010).

In *Intermountain Ins. Serv. of Vail*, the Tax Court considered how to apply the effective date provision in the temporary regulations. The IRS argued:

> To determine whether the temporary regulations are applicable under the effective date provision, the Court must determine whether a six-year statute of limitations would be open for the taxable year at issue, as of September 24, 2009, without regard to what the standard for applying the statute of limitations might be. If the six-year limitations period could be open under some standard as of September 24, 2009, then the temporary regulations apply.

Intermountain Ins. Serv. of Vail, LLC v. Comm'r, 134 T.C. 211, 218 (2010) (reviewed by the court), *rev'd*, 650 F.3d 691 (D.C. Cir. 2011), *vacated by* No. 10-1204, 2012 U.S. App. LEXIS 11811 (D.C. Cir. June 11, 2012).

The Tax Court majority disagreed with the IRS. It explained: "We concluded in our September 1, 2009, opinion [in the same case] that the general 3-year limitations period of section 6501(a) was the applicable period for assessing tax in this case and that it had expired some time before September 14, 2006." 134 T.C. at 218. It noted that to apply the IRS's interpretation, it would have to depart from its holding in *Bakersfield Energy Partners*, 128 T.C. 207 (2007), which, as indicated above, had since been affirmed by the Court of Appeals for the Ninth Circuit. *Id.* at 218–19.

As discussed in Chapter 2 of this Supplement, after finding that the temporary regulations did not apply because of their effective date provision, the Tax Court then found the regulations invalid. *See id.* at 218, 224. The concurrence found the regulations procedurally invalid because the public had not had an opportunity to comment before the regulations became effective. *Id.* at 226 (Cohen, J., concurring in the result) (citations omitted).

Following *Bakersfield*, the Tax Court continued to find *Colony* applicable, and thus to hold that overstatement of basis is not an omission from gross income. *See* Carpenter Family Invs., LLC v. Comm'r, 136 T.C. 373, 381 (2011), which includes an extensive discussion of the implications of *Mayo Foundation for Medical Research v. United States*, 131 S. Ct. 704 (2011), discussed above in connection with Chapter 2, and *Brand X*. *Id.* at 389–95.

In early 2011, the Seventh Circuit issued its ruling in *Beard v. Commissioner*, 633 F.3d 616, 623 (7th Cir. 2011), in which it held that an overstatement of basis is an omission from gross income.[12] The *Beard* court also indicated that it would be inclined to apply *Chevron* deference to the regulations if it found that *Colony* applied, which it did not. *Id*. By contrast, in two cases decided in February 2011, Courts of Appeals held that *Colony* controlled and that the overstatement of basis does *not* constitute an omission from gross income. *See* Home Concrete & Supply, LLC v. United States, 634 F.3d 249, 255 (4th Cir. 2011), *aff'd*, 132 S. Ct. 1836 (2012); Burks v. United States, 633 F.3d 347, 349 (5th Cir. 2011), *cert. denied*, 132 S. Ct. 2099 (2012).

In March 2011, the Court of Appeals for the D.C. Circuit found that sections 6501(e)(1)(A) and 6229(c)(2) are ambiguous. Grapevine Imps. Ltd. v. United States, 636 F.3d 1368, 1378 (D.C. Cir. 2011).[13] Applying *Chevron* deference to the final regulations, it found the Treasury Regulations to be a reasonable interpretation of the statute. *Id.* at 1380–81. The D.C. Circuit concluded that an overstatement of basis does constitute omission from gross income, thus triggering the extended limitations period. *Id.* at 1384.

In September 2011, the Supreme Court granted certiorari in *Home Concrete*. *United States v. Home Concrete & Supply, LLC*, 132 S. Ct. 71 (2011). Justice Breyer delivered the

[12] That judgment was subsequently vacated and the case remanded for further consideration in light of the Supreme Court's decision in *Home Concrete*. Beard v. Comm'r, 132 S. Ct. 2099 (2012).
[13] As in *Beard*, the circuit court's judgment in *Grapevine Imports* was vacated and the case remanded for consideration in light of the Supreme Court's *Home Concrete* decision. Grapevine Imps., Ltd. v. United States, 132 S. Ct. 2099 (2012).

opinion of a divided Court, which held that *Colony* applied and thus the three-year statute applied to the taxpayer's transaction involving the overstatement of basis. *Home Concrete*, 132 S. Ct. 1836, 1839 (2012).[14] The Court reasoned, in part:

> In our view, *Colony* determines the outcome in this case. The provision before us is a 1954 reenactment of the 1939 provision that *Colony* interpreted. The operative language is identical. It would be difficult, perhaps impossible, to give the same language here a different interpretation without effectively overruling *Colony*, a course of action that basic principles of *stare decisis* wisely counsel us not to take.

Id. at 1841.

Because the *Home Concrete* Court found that *Colony* left no room for a different interpretation of the statute by the Treasury, it found the Treasury regulations invalid. *See id.* at 1842–43. It therefore did not need to address the issue, mentioned during the oral argument, of whether *Brand X* would allow a regulation to overturn a Supreme Court decision that had found the statute ambiguous. *See* Transcript of Oral Argument at 55, *Home Concrete*, 132 S. Ct. 1836 (No. 11-139), *available at* http://www.supremecourt.gov/oral_arguments/argument_transcripts/11-139.pdf.

The Tax Court opined on the scope of *Home Concrete* in *Barkett v. Commissioner*, 143 T.C. 149 (2014). In *Barkett*, the Tax Court considered whether the gross income the taxpayer stated in the return (the base for the 25% calculation) included only gains from the sale of investment property (the IRS's argument), rather than the amount realized from the sale of investment assets (the taxpayer's position). *Id.* at 149, 152. The Tax Court held that the *Home Concrete* decision did not affect prior Tax Court cases holding gross income to include only gains from the sale of investments, not the amounts realized from the sales. *Id.* at 155. Specifically, the Tax Court held that *Home Concrete* did not invalidate the portion of Treas. Reg. § 301.6501 dealing with the calculation of gross income stated on the return. *Id.* at 154. Because the taxpayers' gains from their sale of investment assets exceeded 25% of the gross income they reported, the six-year limitation period applied. *Id.* at 156–57.

§ 7.03[C][3] (False or Fraudulent Return)

The issue of whether the statute of limitations for fraud applies if fraud was committed by the return preparer but not the taxpayer is an interesting one. In *City Wide Transit, Inc. v. Commissioner*, 709 F.3d 102 (2d Cir. 2013), the Court of Appeals for the Second Circuit faced that issue. In *City Wide*, the business's owner hired someone named Manzoor Beg—who falsely held himself out as a CPA—to negotiate certain payroll tax liabilities unrelated to the case. *Id.* at 103. Beg then filed a series of false returns on Form 941, claiming advance earned income credit

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[14] The Court also disposed of nine cases addressing the same issues by either denying certiorari or granting certiorari and vacating the lower court opinions. *See Supreme Court Disposes of Nine Appeals of Issues Resolved by "Home Concrete" Ruling*, DAILY TAX REP. (BNA), May 1, 2012, at K-1.

payments that "significantly reduced City Wide's tax liabilities" and deposited the checks intended for the IRS in an account he controlled. *Id.* at 104. Beg also amended other City Wide returns to include fraudulent earned income credit payments, presumably to help cover up the other fraud. *Id.* As a result, "Beg embezzled hundreds of thousands of dollars from City Wide, and City Wide received certain tax refunds." *Id.*

The government prosecuted Beg and he pled guilty to preparing false tax returns. *Id.* The IRS then audited City Wide and assessed tax, without including any fraud penalties. *Id.* at 105. In a CDP hearing and subsequent Tax Court suit, City Wide challenged the assessments as time-barred because they were outside of the normal three-year limitations period. *Id.* However, the Tax Court observed that the IRS could benefit from the unlimited limitations period for fraudulent returns or those filed with the willful intent to evade tax if it could "show by clear and convincing evidence that Mr. Beg had the specific intent to evade taxes known to be owing by conduct intended to conceal, mislead, or otherwise prevent the collection of taxes." City Wide Transit, Inc. v. Comm'r, T.C. Memo. 2011-279, 2011 Tax Ct. Memo LEXIS 270 at *19. The Tax Court sided with the taxpayer, finding that tax evasion was only an incidental consequence of Beg's primary embezzlement scheme. *See City Wide*, 709 F.3d at 106.

The Court of Appeals reversed, finding that the Tax Court's decision was clearly erroneous because "Beg's scheme was tax evasion; tax evasion was not a subordinate element to a more grandiose scheme. It is of no consequence that Beg evaded City Wide's taxes for his own benefit, and the tax court should have allowed the Commissioner to assess the taxes that City Wide owed because of Beg's returns and amendments." *Id.* at 108. Furthermore, "the tax court inappropriately substituted motive for intent. The statute is agnostic as to the attendant motivations for submitting a fraudulent return and only requires that the Commissioner prove a fraudulent return was filed with an intent to evade, that is avoid, paying a tax otherwise due." *Id.* at 107. The Second Circuit thus ruled for the IRS, giving it an unlimited time in which to assess the taxes in issue. *Id.* at 109.

For an interesting discussion of the *Allen* preparer-fraud case discussed in the text and other cases, see Steve Toscher & Della Bauserman, *Surprise—The Fraud of Your Tax Preparer May Extend the Statute of Limitations on Tax Assessments*, J. TAX PRAC. & PROC., Apr.-May 2013, at 23. For a critique of IRS efforts to extend the statute of limitations on assessment based on preparer fraud, see Jeremiah Coder, *The IRS's Misguided Fraud Whodunit*, 137 TAX NOTES 7 (2012).

§ 7.03[D] (Tolling of the Statute of Limitations on Assessment)

In *Shockley v. Commissioner*, 686 F.3d 1228 (11th Cir. 2012), the question was whether a Tax Court petition challenging the validity of a notice of deficiency constituted a "proceeding in respect of the deficiency" that suspended the statute of limitations on assessment under section 6503. The notice in question had been sent with respect to Shockley Communications Corporation ("SCC") but was mailed to the residential address of Terry and Sandra Shockley, SCC's former officers and shareholders. *Id.* at 1231.

Reversing the Tax Court, the Court of Appeals for the Eleventh Circuit found that the petition did suspend the running of the statute of limitations. *Id.* at 1230. The court reasoned as follows:

> First, the proceeding need only be “in respect of” the deficiency, not seeking “a redetermination of” the deficiency. The phrase “in respect of” is particularly comprehensive, with one dictionary ascribing a definition of “as to; as regards; insofar as concerns; [or] with respect to.” Webster’s Third New International Dictionary 1934 (1993) . . . . This choice of phrase is in contrast to a closely related statute, § 6213(a), where Congress selected the more specific phrase “redetermination of” the deficiency. In our view, the phrase “in respect of” in § 6503(a)(1) requires only that the substance of the proceeding concern the deficiency.
>
> Second, § 6503(a)(1)’s language refers to a “proceeding” and casts the phrase in the passive voice. This construction emphasizes the “proceeding,” not who places it on the docket, as the crucial fact. By contrast, again, in § 6213(a), the active voice is used to create a specific statutory suspension when the “taxpayer” files a “petition” for “redetermination of” the deficiency. See I.R.C. §§ 6213(a), 6503(a)(1). In short, Congress established a mechanical, bright-line test that would suspend the limitations period of § 6501 automatically upon the placing of any “proceeding in respect of the deficiency” on the Tax Court docket. To interpret § 6503(a)(1) otherwise would present the IRS with the Hobson’s choice of deciding between assessing the taxpayer’s liability at the risk of doing so prematurely, and waiting until the resolution of the proceeding at the risk of doing so too late.

Id. at 1235–36 (alteration in original) (footnote omitted).

For an argument that *Shockley* could upset settled law protecting taxpayers, see Andy R. Roberson & Kevin Spencer, *11th Circuit Allows Invalid Notice To Suspend Assessment Period*, 136 TAX NOTES 709 (2012). Roberson and Spencer argue that, under *Shockley*,

> the IRS could issue a defective or invalid notice of deficiency—for example, a notice issued before the completion of a related partnership proceeding, a notice not mailed to the taxpayer’s last known address, a notice that does not correctly identify the taxpayer or the amount of the deficiency—and after the taxpayer goes through the time and expense of filing a petition and moving to dismiss the case for lack of jurisdiction, the IRS could come back within 60 days with a new notice that cures the defect in the invalid notice and possibly raises new issues or theories. Giving the IRS multiple bites of the proverbial apple defeats the entire purpose of the statutory framework related to the period of limitations on assessment—finality.

Id. at 711. For a thoughtful discussion of *Shockley*, TEFRA, and tolling, see Robert W. Wood, *For Whom the Statute Tolls*, 140 TAX NOTES 1035 (2013).

In *Seven W. Enters., Inc. v. Commissioner*, 723 F.3d 857 (7th Cir. 2013), the Tax Court had issued opinions affirming deficiencies against Seven W. and another taxpayer, Highland. Although the Tax Court's opinions were correct, its decisions were mixed up: they attributed Seven W.'s deficiencies to Highland, and vice versa. *Id.* at 858. The IRS discovered the error and sought to file a motion to vacate the decisions; the taxpayers did not object to the necessary corrections, but they did object to vacatur. *Id.* at 859. The Tax Court sided with the IRS, however, and the taxpayers appealed. *Id.* On appeal, the Court of Appeals for the Seventh Circuit agreed with the taxpayers that "absent a fraud that infected the Tax Court's decision, the Tax Court cannot vacate a decision that has become final." *Id.* at 862. The court thus remanded for the Tax Court to reinstate its original decisions, as amended to reflect the correct liabilities for each taxpayer. *Id.*

As one commentator explained, "[a]lthough the Seventh Circuit's ruling in *S.W. Enterprises* is not a landmark decision on the issue of the Tax Court's authority to grant a motion to vacate, the true significance of the ruling is its effect on the IRS's attempt to create a loophole in the statute of limitations." Philip D. Speicher, *Seventh Circuit Rejects Tax Court's Grant of Post-Trial Motion to Vacate Decision as Circumvention of Expired Statute of Limitations for Assessment*, J. TAX PRAC. & PROC., Oct.-Nov. 2013, at 17, 18. The decision "preserves the integrity of the statute of limitations" and resolves any doubt concerning a hypothetical IRS attempt to "use a post-trial procedural motion to bootstrap an assessment otherwise barred by the statute of limitations." *Id.* at 49.

§ 7.03 [E] (Extensions of Time to Assess Tax)

Partially redacted 2013 and 2014 TIGTA reports found that the IRS is generally compliant with the requirements of Code section 6501(c)(4)(B), which requires the IRS to notify the taxpayer of the right to refuse or limit an extension of the statute of limitations. *See* TREASURY INSPECTOR GEN. FOR TAX ADMIN., FISCAL YEAR 2014 STATUTORY AUDIT OF COMPLIANCE WITH NOTIFYING TAXPAYERS OF THEIR RIGHTS WHEN REQUESTED TO EXTEND THE ASSESSMENT STATUTE 5–8 (2014), *available at* http://www.treasury.gov/tigta/auditreports/2014reports/201430066fr.pdf; TREASURY INSPECTOR GEN. FOR TAX ADMIN., FISCAL YEAR 2013 STATUTORY AUDIT OF COMPLIANCE WITH NOTIFYING TAXPAYERS OF THEIR RIGHTS WHEN REQUESTED TO EXTEND THE ASSESSMENT STATUTE 5–7 (2013), *available at* http://www.treasury.gov/tigta/auditreports/2013reports/201330071fr.pdf.

In *Hartland Management Services., Inc. v. Commissioner*, T.C. Memo 2015-8; 2015 Tax Ct. Memo LEXIS 20, the Tax Court held that a Form 872 was effective to extend the assessment period for the tax years at issue, despite erroneously specifying a different tax year. *Id.* at *14. The taxpayers had originally intended to extend the limitations period for tax years 2008 and 2009. *Id.* at *5. Instead, the Forms 872 listed tax year 2012. *Id.* at *4. The IRS requested the taxpayers sign new Forms 872, which they refused to do. *Id.* at *5–6. The IRS then issued notices of deficiency for tax years 2008 and 2009. *Id.* at *2, 5–6. The IRS argued that the erroneous Forms 872 amounted to a scrivener's error. *Id.* at *10. The Tax Court ruled in favor of the IRS because it found that the IRS had "established by clear and convincing evidence that petitioners intended to extend the period of limitation for the disputed years and that the initial Forms 872 may be reformed to conform with the intent of the parties." *Id.* at *14.

Chapter 8

§ 8.01[A] (Structure)

The U.S. Tax Court's place in the government hierarchy continues to be a source of confusion. After the taxpayer in *Byers v. Commissioner*, 740 F.3d 668 (D.C. Cir. 2014) prevailed in the D.C. Circuit, he made a FOIA request to the Clerk of the Tax Court for copies of certain Tax Court internal procedures. *See* Carl Smith, *Is the Tax Court an Agency or a Court for FOIA Purposes?*, PROCEDURALLY TAXING (June 10, 2015), http://www.procedurallytaxing.com/is-the-tax-court-an-agency-or-a-court-for-foia-purposes/. The Tax Court denied his request stating that, "The United States Tax Court is a court of law. . . . Consequently, the Tax Court is not an 'agency' subject to FOIA." *Id.* (quoting a letter from the Tax Court Clerk to Mr. Byers).

In 2014, the Court of Appeals for the D.C. Circuit considered whether Code section 7443(f), which allows the President to remove Tax Court judges on grounds of "inefficiency, neglect of duty, or malfeasance in office," is a violation of the separation of powers doctrine. *Kuretski v. Commissioner*, 2014 U.S. App. LEXIS 11611 at *1–2 (D.C. Cir. June 20, 2014). The Kuretskis argued that section 7443(f) allows for improper "interbranch" removal of Tax Court judges by the President of the United States because, they argued, the Tax Court exercises judicial power under Article III of the Constitution. *Id.* at *2. They therefore requested that the Tax Court's opinion, which found in favor of the IRS, be vacated and that they receive a new trial before a Tax Court judge free from the threat of interbranch removal. *Id.*

In *Kuretski*, the taxpayers had filed a joint income tax return for 2007 in which they reported a $23,601.50 balance due but did not include any payment. *Id.* at *8. After the IRS assessed that amount, plus penalties and interest, the Kuretskis were notified that they had 30 days to pay the balance or be subject to levies on their property. *Id.* The Kuretskis filed a request for a collection due process hearing and submitted an offer in compromise for partial payment of the liability, which the IRS rejected. *Id.* at *9. The IRS countered with a full payment offer that the taxpayers did not accept. *Id.* at *9–10.

At trial in the Tax Court, the taxpayers argued that the settlement officer abused her discretion by issuing a notice of determination when the parties were close to reaching an agreement. *Id.* at *10. After the Tax Court rejected this argument and ruled in favor of the IRS, the Kuretskis filed a motion for reconsideration and asked the Tax Court to vacate its decision on the ground that section 7443(f) is unconstitutional. *Id.* at *11. The Tax Court denied both motions and declined to consider the Article III issue, stating that the Kuretskis had failed to explain why they waited to raise the argument until after the court issued its decision. *Id.* at *12.

On appeal, the D.C. Circuit considered the taxpayers' constitutional argument, stating:

> Just as the Supreme Court in *Freytag* [*v. Commissioner*, 501 U.S. 868 (1991)] elected to consider a belated constitutional challenge to the validity of a Tax

> Court proceeding, . . . we do so here. In *Freytag*, as here, the petitioners raised a nonfrivolous constitutional challenge to the validity of a Tax Court proceeding after the Tax Court's initial decision, and the petitioners' claim implicated the federal judiciary's strong interest in maintaining the separation of powers.

Id. at *16. The taxpayers' argument on appeal rested on their claim that the Tax Court "exercises 'judicial power' under Article III of the Constitution. In the alternative, the Kuretskis contend[ed] that the Tax Court is part of the Legislative Branch." *Id.* at *21. This would render removal of a judge by the president "interbranch" removal. *Id.*

The D.C. Circuit disagreed. It first held that the Tax Court was not an Article III court:

> Congress undisputedly . . . initially established the Tax Court as an Executive Branch agency rather than an Article III tribunal. *See* Revenue Act of 1924 § 900(k), 43 Stat. at 338 (Board of Tax Appeals established as independent executive agency) . . . . The Kuretskis believe that Congress shifted course in the 1969 Tax Reform Act, when it . . . provided that the Tax Court was "established[] under article I of the Constitution." 26 U.S.C. § 7441. There is no indication, however, that by prescribing that the Tax Court had been established under Article I, Congress somehow converted what had been an Executive Branch tribunal into an Article III court. The legislative history in fact indicates a belief and intention that the Tax Court is not an Article III body. . . . It would seem clear, then, that the Tax Court is not a part of the Article III Judicial Branch, and that its judges do not exercise the "judicial Power of the United States" under Article III.

Id. at *25–26 (citations omitted). The Court of Appeals then addressed *Freytag*, in which the U.S. Supreme Court, in an Appointments Clause challenge to Special Trial Judges, held that the Tax Court is a "court of law," not an executive "Department." *Id.* at *26. The D.C. Circuit noted that the Supreme Court stated in *Freytag* that "non-Article III tribunals . . . exercise the judicial power of the United States," and that *Freytag* did not hold that the Tax Court is an Article III court. *Id.* at *29–30 (quoting *Freytag*, 501 U.S. at 889).

The Court of Appeals then considered the taxpayers' fallback argument that the Tax Court is part of the legislative branch because it is a legislative court under Article I of the Constitution. *Id.* at *31. The court acknowledged both Code section 7441 and *Freytag*'s statement that Congress had intended to transform the Tax Court from an agency into a legislative court. *Id.* at *31. However, the court stated, "But even if the 1969 Act transformed the Tax Court into an Article I legislative court, it did not thereby transfer the Tax Court to the Legislative Branch." *Id.* at *31–32. It further stated that "[t]he Tax Court's status as an 'Article I legislative court,' Freytag, 501 U.S. at 888, does not mean that its judges exercise 'legislative power' under Article I." *Id.* at *34.

Seemingly by process of elimination, then, the Court of Appeals held, "[i]t follows that the Tax Court exercises its authority as part of the Executive Branch." *Id.* at *35. It dealt with the seeming conflict with *Freytag* as follows:

> That conclusion is fully consistent with *Freytag*. The *Freytag* majority rejected the argument that the Tax Court is an executive "Department" for purposes of the Appointments Clause. *See Freytag*, 501 U.S. at 888. But the majority also made clear that an entity can be a part of the Executive Branch without being an executive "Department." *See id.* at 885 ("We cannot accept the Commissioner's assumption that every part of the Executive Branch is a department, the head of which is eligible to receive the appointment power."); id. at 886 ("a holding that every organ in the Executive Branch is a department would multiply indefinitely the number of actors eligible to appoint"). One of our sister circuits thus understands Freytag to hold that "the Tax Court is a Court of Law *despite being part of the Executive Branch*." S.C. State Ports Auth., 243 F.3d at 171 (emphasis added).
>
> The *Freytag* majority also observed that the Tax Court "remains independent of the Executive . . . Branch[]," and in that sense exercises something other than "executive" power. 501 U.S. at 891. We understand that statement to describe the Tax Court's functional independence rather than to speak to its constitutional status. The Supreme Court has used similar language to describe "quasilegislative" and "quasijudicial" agencies such as the Federal Trade Commission, noting that such agencies are "wholly disconnected from the executive department" and that their members must "act in discharge of their duties independently of executive control." Humphrey's Ex'r v. United States, 295 U.S. 602, 629-30 . . . (1935). . . .
>
> In relevant respects, the constitutional status of the Tax Court mirrors that of the Court of Appeals for the Armed Forces. The statutes establishing the status of the two courts precisely parallel one another. Each provides that the respective court is a "court of record" "established under article I of the Constitution." 10 U.S.C. § 941 (Court of Appeals for the Armed Forces); 26 U.S.C. § 7441 (Tax Court). In fact, when Congress in 1969 enacted that language for the Tax Court, it specifically sought to bring the Tax Court into alignment with the Court of Appeals for the Armed Forces (then known as the Court of Military Appeals). *See* S. Rep. No. 91-552, at 304 ("The bill establishes the Tax Court as a court under Article I of the Constitution," and "[a]t the present time, the Court of Military Appeals is the only other Article I court."). . . .
>
> Congress did not, however, move the Tax Court outside the Executive Branch altogether. Indeed, the Supreme Court has recognized that the Court of Appeals for the Armed Forces is an "Executive Branch entity" and that its judges are "Executive officers." Edmond v. United States, 520 U.S. 651, 664-65 . . .

(1997); *see id.* at 664 n.2 (finding it "clear that [the Court of Appeals for the Armed Forces] is within the Executive Branch"). Congress sought to—and did—achieve the same status for the Tax Court.

The Court of Appeals therefore found no constitutional problem with Code section 7443(f). After briefly considering the taxpayers' due process argument, the court affirmed the Tax Court's decision in favor of the IRS.

The taxpayers petitioned the D.C. Circuit for a rehearing *en banc*, which the D.C. Circuit denied. *See* Kuretski v. Comm'r, 755 F.3d 929 (D.C. Cir. 2014), *petition for rehearing denied*, 2014 U.S. App. LEXIS 15021 (D.C. Cir. Aug. 1, 2014) (No. 13-1090). The taxpayers then filed a petition for certiorari to the Supreme Court seeking to invalidate the D.C. Circuit's decision. *See* Kuretski v. Comm'r, 755 F.3d 929 (D.C. Cir. 2014), *petition for cert. filed*, (U.S. Nov. 26, 2014) (No. 14-622). In their petition, taxpayers argued that the D.C. Circuit's decision was contrary to the Supreme Court's holdings in *Freytag* and *Bowsher v. Synar*, 478 U.S. 714 (1986).

The Supreme Court denied certiorari. *See* Kuretski v. Comm'r, 135 S. Ct. 2309 (2015). This issue may resurface, however, because other litigants are raising it. *See* Carl Smith, *IRS Argues that Tax Court Is Located in the Executive Branch*, PROCEDURALLY TAXING (June 22, 2015), http://www.procedurallytaxing.com/irs-argues-that-tax-court-is-located-in-the-executive-branch-2/ ("In order to try to create a Circuit split, lawyers from Fuesrt Ittleman David & Joseph, PL in Miami filed identical motions in seven Tax Court dockets over the last few months asking the Tax Court to declare section 7443(f) unconstitutional for the same reasons articulated by the taxpayers in *Kuretski*."). In the cases the IRS had filed responses to at that time, it argued that the Tax Court is located in the Executive Branch, "though carefully not ever calling the Tax Court an 'agency' in its papers." *Id.*

The *Kuretski* court did not face the topical issue of the extent to which the Tax Court is a reviewing court for purposes of the Administrative Procedure Act (APA). For discussion of the potential impact of *Kuretski* on that issue, as well as other implications of the *Kuretski* case, see the following posts on TaxProf Blog: Paul Caron, *Hoffer & Walker:* Kuretski*, the Tax Court, and the Administrative Procedure Act*, TAXPROF BLOG, June 24, 2014, http://taxprof.typepad.com/taxprof_blog/2014/06/hoffer-walker-.html; Paul Caron, *Hickman:* Kuretski v. Commissioner*: A Fun and Fascinating Bit of Academic Folderol?*, TAXPROF BLOG, June 23, 2014, http://taxprof.typepad.com/taxprof_blog/2014/06/hickman-kuretski-v-commissioner-.html; Paul Caron, *Smith: Reflections on* Kuretski*'s Holding That the Tax Court Is Part of the Executive Branch*, TAXPROF BLOG, June 22, 2014, http://taxprof.typepad.com/taxprof_blog/2014/06/smith.html. For an argument that the Tax Court is a reviewing court under the APA, see Stephanie R. Hoffer & Christopher J. Walker, *The Death of Tax Court Exceptionalism*, 99 MINN. L. REV. 221 (2014), *available at* http://ssrn.com/abstract=2393412.

§ 8.01[B] (Procedures)

During 2009, the Tax Court made several changes to its Rules of Practice and Procedure. Some of the changes were designed to make Tax Court rules more similar to the Federal Rules of Civil Procedure. *See* U.S. Tax Court Press Release (Sept. 18, 2009), *available at* http://www.ustaxcourt.gov/press/091809.pdf [hereinafter *September 18 Press Release*]. The amendments include changes to the Tax Court Rules relating to interrogatories and depositions. Amended Rule 71(a) provides:

> Unless otherwise stipulated or ordered by the Court, a party may serve upon any other party no more than 25 written interrogatories, including all discrete subparts but excluding interrogatories described in paragraph (d) of this Rule, to be answered by the party served or, if the party served is a public or private corporation or a partnership or association or governmental agency, by an officer or agent who shall furnish such information as is available to the party. A motion for leave to serve additional interrogatories may be granted by the Court to the extent consistent with Rule 70(b)(2).

TAX CT. R. 71(a).

New Tax Court Rule 74, which is quite lengthy, replaces former Rules 74 to 76. The Tax Court explained this change, in part, as follows:

> The Court's existing Rules governing depositions for discovery purposes are amended to provide that a party may move to take the deposition of another party or the Court in the exercise of its discretion may order the deposition of a party sua sponte. The deposition of a party without consent is an extraordinary method of discovery and may be taken only pursuant to an order of the Court. . . . A Judge or Special Trial Judge should only order such a deposition where the testimony or information sought practicably cannot be obtained through informal communications or the Court's normal discovery procedures and to the extent consistent with Rule 70(b)(2).
>
> In conjunction with this amendment, Rules 74, 75, and 76 are merged into a single new Rule 74 so as to improve clarity, eliminate redundancies, and to streamline the Court's Rules. New Rule 74 contains provisions governing all depositions that may be taken for discovery purposes in Tax Court proceedings.

September 18 Press Release, *supra*, at 24.

During a Federal Bar Association Section on Tax Law panel discussion, Tax Court Judge Holmes stated, "the changes to the Tax Court rules will likely cause an increase in the number of discovery motions in large Tax Court cases." Sam Young, *Tax Court Judge, IRS Attorneys*

Discuss Impact of Changes to E-discovery Rules, 2010 TAX NOTES TODAY 44-13 (Mar. 5, 2010). For further discussion of these 2009 amendments, see Adam Treiser, *Tax Court Amends Its Rules of Practice and Procedure*, J. TAX PRAC. & PROC., Dec. 2009-Jan. 2010, at 39.

In 2009, the Tax Court also added new Rule 26, which permits the electronic filing of documents beginning January 1, 2010. *See* TAX CT. R. 26. The court has since made electronic filing mandatory in most cases in which the taxpayer is represented by counsel, beginning with petitions filed July 1, 2010. *See Tax Court Announces Mandatory eFiling for Most Represented Parties* (May 6, 2010), *available at* http://www.ustaxcourt.gov/eaccess/Mandatory_eFiling_Announcement.pdf.

The Tax Court made further amendments to its Rules of Practice & Procedure, effective May 5, 2011. *See U.S. Tax Court Notice, Rules of Practice & Procedure*, *available at* http://www.ustaxcourt.gov/rules/amended_050511.pdf. The Tax Court's press release provided the following description of the amendments:

> The amendments as adopted include amended time periods for filing summary judgment motions, Rule 155 computations, and motions regarding elections to proceed under the small tax case procedure. The Court has also amended Rule 24 to recognize the role of law students who assist in cases under direct supervision of counsel, and Rule 124 to recognize more clearly voluntary nonbinding mediation as a form of dispute resolution. In addition, the Court has adopted various technical, clarifying, and conforming amendments to its Rule and forms.

Tax Court Press Release, May 5, 2011, *available at* http://www.ustaxcourt.gov/press/050511.pdf.

Several of the amended rules add references to Special Trial Judges. For example, the court amended Rule 12 to permit a Special Trial Judge to authorize the removal of records from the courtroom. Rule 22 was amended to include a Special Trial Judge as an individual who can permit or require the filing of documents at a trial session. *See id.* at 2–3.

The court amended Rule 50 to allow motions to be heard in all of the court's places of trial, not only in Washington, D.C. *Id.* at 7–8. Rule 124 was modified to remove arbitration as the focus of the rule; it was renamed "Alternative Dispute Resolution," to emphasize the use of other means of dispute resolution, such as mediation. *Id.* at 12–13.

Rule 171 was replaced with a new Rule, essentially identical to the old Rule 172(b), which describes the procedure for electing small tax case status. The petitioning taxpayer may request that the case be conducted as a small tax case at the time the petition is filed. If the Commissioner opposes the request, the Commissioner must file such a motion with the answer. If the petitioner requests small tax case status after the Commissioner has filed an answer, the Commissioner may move without leave of court that the proceeding not be conducted as a small tax case. *Id.* at 15.

In December 2011, the Tax Court announced proposed amendments to its Rules of Practice and Procedure. *See Tax Court Press Release, Dec. 28, 2011*, *available at* http://www.ustaxcourt.gov/press/122811.pdf. The proposed amendments included, among many others, amending Rule 23 to reduce the number of copies required for papers filed in paper form; a conforming amendment deleting Rule 175, so that the number of copies required for S cases would be the same as in other cases; amending rule 26 to require electronic filing for most represented parties; amending Rules 70 and 143 to conform to Federal Rule of Civil Procedure 26 with respect to expert witness reports, the work product doctrine, and certain discovery matters; and the addition of a new rule, Rule 345, to provide privacy protections in whistleblower cases. The amendments became effective July 6, 2012. *See Tax Court Press Release, July 6, 2012*, *available at* http://www.ustaxcourt.gov/press/070612.pdf.

In 2012, the IRS Office of Chief Counsel updated its procedures relating to electronically stored information, issuing a Notice that requires it to issue timely, written notices of litigation holds to "key custodians" of information and discuss search terms with the taxpayer to narrow the searches to those "more likely to locate relevant material." Chief Counsel Notice CC-2012-017 (Sept. 13, 2012), *available at* http://www.irs.gov/pub/irs-ccdm/cc-2012-017.pdf. The new procedures will not apply in most small tax cases, automated underreporting cases, substitute-for-return cases, and cases involving labor, employment, procurement, and contracts. *Id.*

Professor Joni Larson has written a guide to navigating the Rules of Evidence at the Tax Court. *See* JONI LARSON, A PRACTITIONER'S GUIDE TO TAX EVIDENCE: A PRIMER ON THE FEDERAL RULES OF EVIDENCE AS APPLIED BY THE TAX COURT (2013).

§ 8.01[D][2] (Deference to Tax Court Decisions)

Court cases have manifested some confusion over the standard of review applicable to Tax Court decisions, and how issues in Tax Court cases are classified as involving law or fact, or mixed questions of law and fact for purposes of appellate review. As explained in the text, in 1948, Congress attempted to overturn the special deference rule of *Dobson v. Commissioner*, 320 U.S. 489 (1943). What is now Code section 7482(a) provides that the Courts of Appeals "shall have exclusive jurisdiction to review the decisions of the Tax Court . . . in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury . . . ." However, in 2011, without citing section 7482, a district court approvingly quoted *Dobson* in support of deference to Tax Court decisions. *See* Cummings v. United States, 866 F. Supp. 2d 42, 47 n.11 (D. Mass. 2011) ("While decisions by the Tax Court are not binding, 'uniform administration would be promoted by conforming to them where possible.'") (quoting *Dobson*, 320 U.S. at 502).

In *Curcio v. Commissioner*, 689 F.3d 217, 225 (2d Cir. 2012), the Court of Appeals for the Second Circuit held that the question of whether certain expenditures qualified as deductible "ordinary and necessary" business expenses under Code section 162(a) was subject to "clear error" review and affirmed the Tax Court's decision that certain contributions to life insurance plans made by small businesses were not deductible under section 162. The court relied heavily on *Commissioner v. Heininger*, 320 U.S. 467 (1943), in determining the standard of review:

> Whether an expense is "ordinary and necessary" within the meaning of § 162(a) is a "pure question[] of fact in most instances." *Comm'r v. Heininger*, 320 U.S. 467, 475 . . . (1943); *accord McCabe v. Comm'r*, 688 F.2d 102, 104 (2d Cir. 1982). Unless "a question of law is unmistakably involved," *Heininger*, 320 U.S. at 475, we review for clear error the tax court's determination that an expense was not an ordinary and necessary business expense, *McCabe*, 688 F.2d at 104–05. *Compare Chenango Textile Corp. v. Comm'r*, 148 F.2d 296, 298 (2d Cir. 1945) (although tax court cited appellate court opinions to justify its conclusion, its decision was a determination of fact) *with Heininger*, 320 U.S. at 475 (tax court mistakenly believed that denial was required as a matter of law). . . .

Curcio, 689 F.3d at 225.

Heininger was decided by the Court on the same day it decided *Dobson*, and *Heininger* cited *Dobson* in support of its statement that

> [w]hether an expenditure is directly related to a business and whether it is ordinary and necessary are doubtless pure questions of fact in most instances. Except where a question of law is unmistakably involved a decision of the Board of Tax Appeals on these issues, having taken into account the presumption supporting the Commissioner's ruling, should not be reversed by the federal appellate courts.

Heininger, 320 U.S. at 475 n.13. *Heininger* therefore constitutes dubious authority for a deferential standard of review of Tax Court decisions.

And in a 2013 case, the Second Circuit explained that, in a 1991 case, it had overlooked section 7482 when it held that it would apply the "clear error" standard to mixed questions of law and fact in Tax Court cases. *Diebold Found., Inc. v. Commissioner*, 36 F.3d 172 (2d Cir. 2013). In *Diebold*, the Second Circuit recognized that it needed to conform that standard to its standard of review of district court cases involving mixed questions of law and fact, which depends on whether the alleged error dealt with the legal or factual aspect of the mixed question. *Id.* at 182. These and other cases are discussed in a recent article, which argues that from historical, doctrinal, and theoretical perspectives, courts owe the Tax Court the same level of review they apply to district court bench decisions. *See* Leandra Lederman, *(Un)Appealing Deference to the Tax Court*, 63 DUKE L.J. 1833 (2014).

In a 2014 case, the D.C. Circuit held that any dispute over the proper interpretation of the venue provisions in Code section 7482(b) "clearly raises a question of law," and thus is subject to a de novo standard. Byers v. Commissioner, 740 F.3d 668, 674–75 (D.C. Cir. 2014).

§ 8.02 (THE TAX COURT'S JURISDICTION AND CASELOAD)

The Tax Court's caseload increased after 2006, but the aggregate dollar amount of its cases decreased. In fiscal year 2007, the court's docket, in thousands, rose to 29.4. That figure rose again in 2008 to 31.9; decreased slightly in 2009 to 30.9; decreased again in 2010 to 29.6; then increased in 2011to 29.9; and increased again in 2012 to just over 30,000 cases. In 2013, the court's docket dropped back to 28.5 thousand cases. In 2014, the caseload rose to 29.2 thousand cases. *See* Chief Counsel Workload: Tax Litigation, by Type of Case–IRS Data Book Table 27, *available at* http://www.irs.gov/uac/SOI-Tax-Stats-Chief-Counsel-Workload-Tax-Litigation-Cases-by-Type-of-Case-IRS-Data-Book-Table-27. By contrast, the court's fiscal year 2007 inventory consisted of cases aggregating only $23.5 billion (down approximately $6 billion from the year before), and that number is similar in 2008 ($23 billion) and 2009 ($23.8 billion). It rose in 2010 to $26.6 billion before falling to $19 billion in 2011, increasing only slightly in 2012 to $20.2 billion, and increasing again in 2013 to approximately $22 billion. In 2014, the cases aggregated $23.5 billion. *Id.*

In *SECC Corporation v. Commissioner*, 142 T.C. No. 12 (2014), 2014 U.S. Tax Ct. LEXIS 12, the Tax Court, in a reviewed decision, asserted what may be regarded as broad jurisdiction in a worker classification case. The crux of the issue was whether the IRS Appeals Office had made a "determination" as required by Code section 7436(a). The Appeals Office sent the taxpayer a letter, but it was not an official "Letter 3523, Notice of Determination of Worker Classification (NDWC)." *Id.* at *6.

In the Tax Court, both parties moved to dismiss for lack of jurisdiction. *Id.* at *7. However, the court concluded that the IRS had made a determination in the case, reflected in the letter it had sent the taxpayer. *Id.* at *13. The court also found that the controversy "includes matters specified in section 7436(a) over which we have jurisdiction." *Id.* at *18. The court ultimately denied both motions to dismiss. *Id.* at *29–30. Judge Halpern filed a brief concurrence, in which 11 other judges joined, "writ[ing] only to emphasize that, not only is the majority's analysis of our jurisdiction under section 7436 correct as a matter of law; it is also correct as a matter of tax policy." *Id.* at *30 (Halpern, J., concurring). Judges Goeke and Kerrigan dissented, arguing, in part that the letter the IRS sent to the taxpayers was insufficient because it was not a notice of determination. *Id.* at *37 (Goeke and Kerrigan, J.J., dissenting).

The majority's holding may be a surprise to some tax practitioners, and commentary suggests that it could raise the prospect of a sweeping approach by the Tax Court on other jurisdictional issues.

> Mark D. Allison of Caplin & Drysdale called the decision fascinating and said it should serve as a wake-up call to practitioners as they think about Tax Court jurisdiction. Practitioners generally view the court's jurisdiction as deriving from statutory-based deadlines, and the notion that jurisdiction can be created by "any mailing that purports to create a controversy in a particular context" adds a new wrinkle to that thinking, he said.

Matthew R. Madara, *Tax Court Retains Jurisdiction over Worker Classification Case*, 143 TAX NOTES 34, 34 (2014).

In *American Airlines Inc. v. Commissioner*, 144 T.C. No. 2 (2015), 2015 U.S. Tax Ct. LEXIS 2, the Tax Court found it had jurisdiction to hear the petitioner's challenge to employment taxes assessed against it for payments made to foreign flight attendants. The issue here again was whether the IRS made a "determination" under Code section 7436(a) and whether an "actual controversy" existed. *Id.* at 13-14. The IRS contended the Tax Court lacked jurisdiction under section 7436(a) because it had not made an official worker classification "determination." *Id.* at 15. The petitioner claimed the IRS made a determination based on a 30 day letter, Appeals case memorandum, and a letter issued by the IRS regarding a potential decision to make a determination under section 7436(a). *Id.* at 20. The Tax Court agreed with the petitioner, citing *SECC Corporation*. *Id.*

While the Tax Court has jurisdiction to hear overpayment claims in cases in which it has deficiency jurisdiction, this jurisdiction is limited. In *Kupersmit v. Commissioner*, T.C. Memo 2014-129, 2014 Tax Ct. Memo LEXIS 131, the Tax Court held it did not have jurisdiction to determine whether petitioner had overpaid her taxes for any year other than 2010, the only year for which the IRS had issued a notice of deficiency. *Id.* at *8. The Tax Court also held it did not have jurisdiction to apply any such overpayment against her 2010 deficiency. *Id.*

§ 8.03 (TAX COURT PLEADING REQUIREMENTS)

In *Halata v. Commissioner*, T.C. Memo. 2012-351, 2012 Tax Ct. Memo LEXIS 352, the Tax Court held that the taxpayer was barred from asserting a net operating loss claim because she failed to raise the issue in her pleadings; instead "[t]he Court and the IRS were not advised of her theory until after trial." *Id.* at *29 (citing Tax Court Rules 31(a) and 34(b)(4)).

In *Smith v. Commissioner*, 140 T.C. 48 (2013) (reviewed by the court), at the time the IRS mailed the notice of deficiency to the taxpayer's last known address in California, she had recently moved to Canada and established permanent residency there. She was in California to move her furniture on the date the notice was mailed and delivered but did not pick it up from her post office box. She did not receive a copy of the notice until about four months later, and she filed her petition 148 days after the notice was mailed. In an opinion authored by Judge Foley, a majority of the Tax Court ruled that the petition was timely because it was "addressed to a person outside the United States" within the meaning of Code section 6213(a). The majority reasoned:

> In *Hamilton*, the Court held that a U.S. citizen who resided in a foreign country was a person "outside" of the United States. Hamilton v. Commissioner, 13 T.C. at 748, 754 (construing the predecessor to the current section 6213). . . .

> In *Hamilton*, the Court mused that a foreign resident "who, through fortuitous circumstance, physically happened to be in one of the States of the Union on the particular day the deficiency notice was mailed" would be entitled to the 150-day period and that any other interpretation of the 150-day rule would not be reasonable. *See* Hamilton v. Commissioner, 13 T.C. at 753-754. The Court in *Lewy v. Commissioner*, 68 T.C. at 784–786, confronted this situation. In *Lewy*, a foreign resident, in the United States on the notice's mailing date, left the country the following day and experienced delay in receiving the notice. *Id.* at 779–780. The Commissioner contended that the taxpayer's physical presence in the United States precluded the applicability of the 150-day rule. *Id.* at 782. The Court rejected this contention as "excessively mechanical, unrelated to the section's basic purpose, and unsupported by case law." *Id.* at 782, 784 (stating that the Court has "firmly and unequivocally rejected barren haggling over dialectical distinctions in the jurisdictional area"). . . .
>
> Petitioner is within the category of taxpayers that Congress intended to benefit. *See* Lewy v. Commissioner, 68 T.C. at 782; Camous v. Commissioner, 67 T.C. [721] at 735 [(1977)]; Hamilton v. Commissioner, 13 T.C. at 753-754. She was a Canadian resident (i.e., when the notice was mailed and delivered); was not at the address to which the notice was delivered; and received the notice, in Canada, 127 days after the notice's mailing date. Although petitioner was in San Francisco when the notice was mailed and delivered, her status as a person "outside of the United States" is largely a function of her residency and is not vitiated by her brief presence in the United States. In short, the 150-day rule is applicable.

Id.

Judges Thornton, Colvin, Vasquez, Gale, Wherry, Paris, and Kerrigan, joined the majority opinion. Judge Goeke concurred in the result. Judge Colvin wrote a separate concurrence that responded to the two dissenting opinions. Judge Halpern dissented, arguing that the Tax Court's interpretation of section 6213(a) has evolved over time, such that "[f]oreign residence as a decisive factor has given way to physical location outside the United States as the 'crucial criterion', applicable both to expatriates and those sojourning abroad, in determining who (despite the notice having been mailed to their U.S. last known address) is 'a person outside the United States.'" *Id.* (Halpern, J., dissenting) (citing Degill Corp. v. Commissioner, 62 T.C. 292 (1972)).

Judge Gustafson filed a brief dissent in which Judges Halpern, Kroupa, Holmes, and Morrison joined. That dissent argued as follows:

> The taxpayer in this case did not file her petition "within 90 days" after the mailing of the IRS's notice of deficiency, *see* 26 U.S.C. sec. 6213(a), but rather

> 148 days. We therefore lack jurisdiction unless "the notice is addressed to a person outside the United States." *Id.* It was not so addressed.
>
> Rather, the notice was addressed to the taxpayer's post office box address in San Francisco, California (an address obviously inside the United States); and at the time the notice was mailed by the IRS and delivered to that post office box, the taxpayer was in San Francisco (i.e., was inside the United States). The notice of deficiency was therefore neither addressed to nor delivered to "a person outside the United States". The deadline for filing a petition was therefore the 90-day deadline.
>
> Various other facts about the taxpayer's situation could be adduced to make the situation appear more sympathetic (e.g., she was very busy moving, and she never saw the notice) or less sympathetic (e.g., she was in San Francisco a full week after delivery but did not check her mail); but the statute makes no mention of such considerations. It provides a 90-day deadline, and it makes an exception only when "the notice is addressed to a person outside the United States." That exception is not met here. I would dismiss the petition.

Id. (Gustafson, J., dissenting).

In *Eichelburg v. Commissioner*, T.C. Memo. 2013-269, 2013 Tax Ct. Memo LEXIS 280, the Tax Court held that the taxpayer's petition was not timely filed despite having been sent in on the last day to file the petition. The problem was the private delivery service the taxpayer used. In *Eichelburg*, the deadline stated in the Notice of Deficiency was September 10, 2012, and the taxpayer sent his petition on that date using the Federal Express "FedEx Express Saver" service. *Id.* at *3. The Tax Court received the petition on September 12. *Id.* The Tax Court agreed with the IRS that FedEx Express Saver is not a "designated delivery service" within the meaning of Code section 7502, so the petition was treated as filed on the day it was *received*, September 12, which was two days late. *Id.* at *3, *8. The court explained:

> In Notice 2004-83, 2004-2 C.B. 1030, the IRS listed all private delivery services that have been designated by the Secretary under section 7502(f). The Federal Express delivery services included on this list are as follows: FedEx Priority Overnight, FedEx Standard Overnight, FedEx 2 Day, FedEx International Priority, and FedEx International First. Notice 2004-83, 2004-2 C.B. at 1030, explicitly states that "FedEx * * * [is] not designated with respect to any type of delivery service not identified above." *Thus, FedEx Express Saver is not a "designated private delivery service" within the meaning of section 7502(f).*

Id. at *6–7 (emphasis added).

The ruling that the taxpayer's petition was untimely meant that the Tax Court lacked jurisdiction over the case. *Id.* at *7. The court spoke to the difficulty of this result:

> We acknowledge that the result we reach may seem harsh. Notice 2004-83, *supra*, was issued nine years ago; private delivery companies may have since initiated delivery services resembling those listed in Notice 2004-83, *supra*; and many taxpayers may be unaware of the nuanced differences among these services. However, this Court may not rely on general equitable principles to expand the statutorily prescribed time for filing a petition. . . . The statute gives us jurisdiction under the "timely mailed, timely filed" rule only if a private delivery service has been "designated by the Secretary." Sec. 7502(f)(2). Because FedEx Express Saver has not been so designated, our hands are tied.

Id. at *7–8 (citation omitted). Because this decision interprets the statutory mailbox rule, Code section 7502, it also has implications for other tax-relating mailings. Taxpayers and their representatives are thus well-advised to be familiar with the list of "designated" private delivery services and not to assume that all services provided by a particular company qualify. Note that, as mentioned in Chapter 7, the IRS has updated its list of private delivery services. *See* IRS Notice 2015-38; 2015-21 I.R.B. 1 (May 6, 2012), *available at* http://www.irs.gov/pub/irs-drop/n-15-38.pdf.

§ 8.05 (PRECEDENT APPLICABLE TO TAX COURT CASES)

For an argument that the Tax Court has potentially limited the *Golsen* doctrine, see Vlad Frants, *The Brazen Challenge: Rethinking the Golsen Rule After* Tigers Eye, 2015 TAX NOTES TODAY 67-6 (Apr. 8, 2015). That article analyzes *Tigers Eye Trading, LLC v. Commissioner*, 138 T.C. 67 (2012) (reviewed by the court). In that case, the Tax Court majority stated that the *Golsen* rule did not apply "where the precedent from the Court of Appeals constitutes dicta or contains distinguishable facts or law." *Id.* at 75. Finding that the D.C. Circuit did not follow applicable regulations in reaching a decision in its case, the Tax Court applied the regulations and distinguished the D.C. Circuit case, reaching an opposite conclusion. *Id.* at 76–77.

In dissent, Judge Holmes challenged the majority's departure from the D.C. Circuit's precedent, stating, "Before today, our Court recognized the importance of circuit-court precedent." *Id.* at 173. His dissent argued that not only did the D.C. Circuit consider the same issue by validly interpreting the Code itself without resorting to the regulations, *id.* at 177, but it was aware of the regulations; the D.C. Circuit cited them three times. *Id.* at 178.

In his article, Frants argues that *Tigers Eye* could be interpreted either as "the Tax Court simply doubt[ing] that the circuit court had clearly spoken to the precise legal issue or did not believe that the facts of each case were on point," or as the following modification of the *Golsen* rule:

> The Tax Court will follow the decision of the court of appeals in cases where the circuit court to which an appeal from the Tax Court lies had previously decided on the issue being considered by the Tax Court *unless* the court of

> appeals, in arriving at its holding on a particular issue, had failed to sufficiently consider and apply relevant and valid Treasury regulations.

Frants, *supra*.

§ 8.06 (THE TAX COURT'S SMALL TAX CASE PROCEDURE)

A substantial portion of the Tax Court's caseload is comprised of S cases. "Chief Counsel statistics for the fiscal year ended September 30, 2009, show that 41.8 percent of the Tax Court's inventory on that date consisted of S cases." Carlton Smith & T. Keith Fogg, *Tax Court Collection Due Process Cases Take Too Long*, 130 TAX NOTES 403 (2011). Similarly, Chief Counsel statistics for the 2012 fiscal year show 41.3 percent of the Tax Court's dockets are S cases. *See* Office of Chief Counsel, Internal Revenue Service, *Report for the American Bar Association Tax Section Court Procedure Committee* 4 (Fiscal Year 2012) (hereinafter, *Report for the American Bar Association Tax Section*). By contrast, S cases represent only .9 percent of all of the dollars in dispute as of that date. *Id.*

In *Koprowski v. Commissioner*, 138 T.C. 54 (2012), the Tax Court held that a decision in an S case is barred from relitigation under the doctrine of res judicata. The court explained:

> If res judicata did not apply to decisions in small tax cases because of a principle that such cases, by their nature, should not bar future litigation, then this principle would be subject to anomalies: Section 6512(a) bars a taxpayer from filing a refund suit for a tax year for which he has previously filed a timely Tax Court petition. On the other hand, section 6215(a) bars the Government from filing suit to collect any part of a deficiency determined by the IRS that the Tax Court has "disallowed". These provisions, equivalent to res judicata, grant preclusive effect to Tax Court litigation, without distinguishing between regular cases and small tax cases. In light of these provisions, it would be incoherent to find that section 7463(b) implicitly exempts small tax cases from the effect of res judicata.
>
> The Court of Claims explicitly held that attempted relitigation after a decision in a small tax case in the Tax Court under section 7463 "is barred under the doctrine of res judicata." Vaitkus v. United States, 230 Ct. Cl. 815, 815 (1982). The text of section 7463(b) permits no other result. We therefore hold that the doctrine of res judicata does bar relitigation after a decision in a small tax case under section 7463.

Id. at 64. *Koprowski* involved a review of an IRS denial of innocent spouse relief claimed by a husband, where the husband had also raised the claim in the S case deficiency proceeding, in a motion for summary judgment he later withdrew. *Id.* at 60–63.

§ 8.07 (OUTCOMES IN TAX COURT CASES AND ALLEGATIONS OF BIAS)

In 2012, 78.3 percent of Tax Court petitions involved *pro se* taxpayers, up only slightly from 2011. *See Report for the American Bar Association Tax Section*, *supra*, at 18. According to these statistics, in 2012, excluding cases on appeal and declaratory judgments, 91.3 percent of S case taxpayers were *pro se*, while 64.6 percent of taxpayers in regular cases were. *See id.* at 13 (calculations by the authors).

§ 8.08 (REVIEW OF LARGE CASES HEARD BY SPECIAL TRIAL JUDGES)

Like the Eleventh Circuit in the *Ballard* decision discussed in the text, the Courts of Appeals for the Fifth and Seventh Circuits ordered the Tax Court to enter Special Trial Judge Couvillion's report as the opinion of the Tax Court. *See Kanter v. Commissioner*, 590 F.3d 410, 414 (7th Cir. 2009); *Estate of Lisle v. Commissioner*, 541 F.3d 595, 597 (5th Cir. 2008). The Seventh Circuit opinion was its third in the case. Unlike the earlier Seventh Circuit *Kanter* opinion, the 2009 opinion was unanimous. For further reading about the events of the *Ballard* line of cases, see, *e.g.*, Steve R. Johnson, *Reforming Federal Tax Litigation: An Agenda*, 41 FLA. ST. U. L. REV. 205, 237–240 (2013) (arguing that "[d]espite the majority's stated rationale . . . *Ballard* [w]as driven by the desire to provide fairness in judicial remedies, rather than by a technical construction of the language and history of a rule."); Leandra Lederman, *Tax Appeal: A Proposal to Make the United States Tax Court More Judicial*, 85 WASH. U. L. REV. 1195 (2008) (arguing that, to increase the Tax Court's accountability after episodes such as the *Ballard* controversy, it should be subject to the Administrative Office of U.S. Courts and the Rules Enabling Act).

In *Snow v. Commissioner*, 142 T.C. 413, 2014 U.S. Tax Ct. LEXIS 27 (2014), the Tax Court held that it lacked the jurisdiction to vacate a "pre-*Ballard*" decision in which Special Trial Judge Goldberg's report favored the taxpayers but the final opinion favored the IRS. *Id.* at 423–25. In the original case, *Snow v. Commissioner*, T.C. Memo. 1996-457, 1996 Tax Ct. Memo LEXIS 478, the Special Trial Judge's report granted the taxpayers' motion to dismiss on grounds that the underlying notice of deficiency had not been sent to their last known address and was therefore invalid. *Snow v. Comm'r*, 142 T.C. at 416. However, the final opinion adopted by Judge Dawson granted the IRS's cross-motion to dismiss on grounds that the notices were valid and petitions were untimely. *Snow v. Comm'r*, T.C. Memo. 1996-457 at *14–15.

In 2013, the taxpayers sought leave to file motions to vacate the order granting the IRS's motion to dismiss, which the Tax Court denied. 142 T.C. at 425. The Tax Court held it was without power to equitably expand its jurisdiction to grant the taxpayers' motion. *Id.* at 421. For further reading about the *Snow* decision on this issue, see Susan Simmonds, *Tax Court Can't Vacate Problematic, Pre-*Ballard *Opinion*, 143 TAX NOTES 1405 (2014).

§ 8.09 (EQUITY IN THE TAX COURT)

In *Menard, Inc. v. Commissioner*, 130 T.C. 54, 58 (2008), the Tax Court considered whether it could apply the equitable recoupment doctrine to allow the taxpayer to offset hospital tax overpayments against income tax deficiencies. The IRS argued that the Tax Court's "authority is limited to taxes over which we have deficiency or overpayment jurisdiction; i.e., income, estate, and gift taxes and excise taxes imposed under chapters 41, 42, 43, and 44." *Id.* at 65.

> In support of his position, respondent attempts to draw parallels between the first and second sentences of section 6214(b). Specifically, while the first sentence of section 6214(b) permits us to consider facts with relation to other taxable years and calendar quarters in determining the correct amounts of the deficiencies for the taxable years properly before us, the provision expressly bars us from exercising jurisdiction to determine whether the tax for those other taxable years or calendar quarters has been overpaid or underpaid. As respondent sees it, just as the first sentence of section 6214(b) limits our jurisdiction, the second sentence of section 6214(b), which grants us authority to apply the doctrine of equitable recoupment, should be narrowly construed so that our jurisdiction is restricted in all events to taxes within our original jurisdiction.

Id. at 65–66. The Tax Court rejected the IRS's argument, finding that "if our jurisdiction is properly invoked upon the filing of a petition for redetermination of a deficiency, we may apply the doctrine in respect of any tax imposed under the Internal Revenue Code so long as the elements necessary to support a claim of equitable recoupment are established." *Id.* at 68.

For discussion of whether the D.C. Circuit's opinion in *Kuretski* will have an effect on the Tax Court's use and application of equitable doctrines, see William R. Davis, *Tax Court Judge Doubts* Kuretski*'s Effect on Equitable Doctrines*, 146 TAX NOTES 1334 (2015).

PROBLEMS

In Problem 5 on page 321, the notice of deficiency sent to Dr. Murray refers to Code section 132. This is not a typographical error. The problem is intended to raise the question of whether the IRS's citation to an incorrect Code section invalidates the notice.

Chapter 9

§ 9.01 (INTRODUCTION)

In footnote 1 on page 325, the citation to the Internal Revenue Manual (IRM) should be updated. The IRM states that the two purposes of the Notice of Deficiency are "[t]o ensure the taxpayer is formally notified of the IRS's intention to assess a tax deficiency" and "[t]o inform the taxpayer of the opportunity and right to petition the Tax Court to dispute the proposed adjustments." IRM 4.8.9.2(2) (effective July 9, 2013).

In *Welch v. United States*, 678 F.3d 1371 (Fed. Cir. 2012), the taxpayer argued that the IRS had not timely mailed notices of deficiency for tax years 1992 and 1995. *Id.* at 1376. The Court of Appeals noted that the government bears the burden of proving that it mailed the notice. *Id.* (citing O'Rourke v. United States, 587 F.3d 537, 540 (2d Cir. 2009); Pietanza v. Commissioner, 92 T.C. 729, 736–37 (1989), *aff'd*, 935 F.2d 1282 (3d Cir. 1991)). The court then applied a two-part test applied by other circuits to determine whether evidence submitted by the IRS is sufficient to demonstrate timely mailing of a notice of deficiency:

> First, where the IRS has (1) established the existence of a notice of deficiency and (2) produced a properly completed PS Form 3877 certified mail log, it is entitled to a presumption of mailing, and the burden shifts to the taxpayer to rebut that presumption by clear and convincing evidence. *See, e.g.*, *O'Rourke*, 587 F.3d at 540–41; *Coleman v. Comm'r*, 94 T.C. 82, 91–92 (1990). Second, in the absence of proof of a notice of deficiency and a properly completed Postal Form 3877 certified mail log, the IRS may meet its burden with evidence that is "otherwise sufficient." *See, e.g.*, *O'Rourke*, 587 F.3d at 540–41; *Coleman v. Comm'r*, 94 T.C. 82, 91–92 (1990).

Id. at 1377. The court went on to find that "the combination of a copy of the 1992 notice and postal return-receipts dated three days after that notice, in combination with a corresponding letter to Welch's representative meet the government's burden of proof of mailing for that tax year, [but] the lack of a 1995 notice and the inability to cross-reference the return-receipts to any specific IRS correspondence simply do not." *Id.* at 1382. It therefore affirmed the Court of Federal Claims only with respect to the 1992 assessment. *Id.*

§ 9.02[B] (General Requirements of the Notice)

In *Williams v. Commissioner*, 131 T.C. 54 (2008), the Tax Court found that it lacked jurisdiction to determine a taxpayer's liability for taxable year 2001 because the notice of deficiency failed to include that year.

In *John C. Hom & Assocs. v. Commissioner*, 140 T.C. 210, 211 (2013), the Tax Court considered whether a notice of deficiency that did not include contact information for the local office of the National Taxpayer Advocate, as required by Code section 6212, was invalid.

Section 6212 states in this regard, "Such notice shall include a notice to the taxpayer of the taxpayer's right to contact a local office of the taxpayer advocate and the location and phone number of the appropriate office." I.R.C. § 6212(a). In *John C. Hom & Assocs.*, the notice of deficiency did include the following statement:

> You also have the right to contact the office of the Taxpayer Advocate. . . . If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this notice of deficiency. Please visit our website at www.irs.gov/advocate/content/0,,id=150972,00.html for the Taxpayer Advocate telephone numbers and addresses for this location.

Id. at 211–12.

The Tax Court concluded that the notice of deficiency was not invalid because "section 6212 does not specify that a notice sent without the specified information is invalid" and "there was no prejudice shown by petitioner." *Id.* at 214. With respect to the lack of prejudice, the court further explained:

> Petitioner does not allege that any attempt to contact the local office of the National Taxpayer Advocate was made. Moreover, it is apparent from the record that petitioner's officer and shareholder is adept at Internet research and could easily have accessed the Web site to locate the appropriate local office of the National Taxpayer Advocate.

Id. at 215.

§ 9.02[C][1] (Can a Court "Look Behind" the Notice of Deficiency?)

In *Johnson v. Commissioner*, T. C. Memo. 2013-90, 2013 Tax Ct. Memo LEXIS 92, Mr. Johnson asserted that he was issued a notice of deficiency "to retaliate against him after he accompanied a tax-return-preparation client to a negotiation with an IRS agent" in the course of which "tempers flared on both sides." *Id.* at *8. The court applied *Greenberg's Express*, reproduced in the text, and refused to look behind the notice because there was no allegation that "a constitutional right of the taxpayer has been violated." *Id*. at *9.

In *Longino v. Commissioner*, T.C. Memo. 2013-80, 2013 Tax Ct. Memo LEXIS 82, the taxpayer asserted that he was issued a notice of deficiency because he had "failed to attend a meeting with an IRS employee." *Id.* at *18. The taxpayer alleged that the notice of deficiency was preceded by the IRS employee marking him as a "no show" although he was not informed that there would be a meeting. *Id.* The court also applied *Greenberg's Express* and refused to look behind the notice because the notice of deficiency was "not the result of conduct that was unconstitutional or so egregious as to jeopardize the integrity of the judicial process." *Id.* at *19.

§ 9.02[C][2] "Arbitrary and Erroneous" Notice of Deficiency

For further reading on "naked assessments," see William D. Elliott, *Tax Practice: Naked Assessments*, TAXES, Jan. 2012, at 1, 5, 12 ("The naked assessment doctrine is seen most commonly when there is unreported income, and often illegal income. The Fifth Circuit, however, has expanded the naked assessment doctrine to information returns, Form 1099 and W-2.")

§ 9.02[C][3] (New Matter)

Estate of Mitchell v. Commissioner, 250 F.3d 696 (9th Cir. 2001), is reprinted in the casebook on pages 342–44. The IRS nonacquiesced in that decision. *See* AOD 2005-01 (June 3, 2005), *available at* http://www.irs.gov/pub/irs-aod/aod200501.pdf ("[T]he appellate court erred in 'looking behind' the notice of deficiency because this case did not involve unreported income.").

In *Cavarillo v. Commissioner*, T.C. Memo. 2014-189, 2014 Tax Ct. Memo LEXIS 189, the Tax Court clarified what constituted a "new matter" under Tax Court Rule 142(a) sufficient to place the burden of proof on the IRS at trial. After examining the notice of deficiency and the IRS's arguments at trial, the Tax Court determined that although the IRS did make a partial concession that reduced the deficiency, *id.* at *46, this was not sufficient to constitute a "new matter" and instead was merely a new theory. *Id.* at *49.

§ 9.02[D][1] (The "Last Known Address" Rule)

In *Pagonis v. United States*, 575 F.3d 809 (8th Cir. 2009), the Court of Appeals for the Eighth Circuit affirmed a District Court decision dismissing the case of a taxpayer who had not received a notice of deficiency. The notice had been sent to the taxpayer by certified mail but was returned unclaimed. *Id.* at 811. She sued in the District Court arguing "that the Due Process Clause, as interpreted in *Jones v. Flowers*, 547 U.S. 220 . . . (2006), required the IRS to make additional attempts beyond the unclaimed certified mailing to provide her with notice before the government assessed the taxes." *Id.* at 812. The Court of Appeals agreed with the District Court that the Anti-Injunction Act, I.R.C. § 7421, barred the taxpayer's suit. *See id.* at 813. The court noted that the statute only requires that the notice of deficiency be *mailed* to the taxpayer's last known address, not received. *Id.*

In *Mabbett v. Comm'r*, No. 14-9003, 2015 U.S. App. LEXIS 7634 (10th Cir. May 8, 2015), the Court of Appeals affirmed a Tax Court decision dismissing the case of a taxpayer who filed a petition more than 90 days after the notice of deficiency had been issued, despite the taxpayer's argument that the IRS had failed to provide "bona fide proof of mailing" of the notice of deficiency. *Id.* at *11–12. Applying the same logic as the *Welch* case, the Tenth Circuit found that the IRS produced sufficient evidence to show that notices of deficiency had been sent to three of the taxpayer's addresses because the IRS produced copies of the notices and Form 3877s for each of the notices. *Id.* at *12. The Court of Appeals also rejected the taxpayer's argument that mailing the notice of deficiency to the taxpayer's last known address is insufficient if the taxpayer is traveling. *Id.* at *6.

In 2010, the IRS released updated guidance on how the IRS learns of a taxpayer's change of address. Revenue Procedure 2010-16, 2010-19 I.R.B. 664, supersedes Revenue Procedure 2001-18, 2001-1 C.B. 708, and is effective June 1, 2010. Whereas Revenue Procedure 2001-18 provided that "[t]he Service *may* . . . *update* a taxpayer's address of record based on a new address that the taxpayer provides the USPS [U.S. Postal Service] that is retained in USPS's NCOA [National Change of Address] database," Rev. Proc. 2001-18 § 4.06 (emphasis added), the new Revenue Procedure provides that "[t]he Service *will* . . . *automatically update* a taxpayer's address of record based on a new address . . . retained in . . . [the NCOA] database." Rev. Proc. 2010-16, *supra*, at § 3.02 (emphasis added). Thus, the IRS has provided for the first time that it will automatically be updating its address records to reflect changes of address with the U.S. Postal Service.

Revenue Procedure 2010-16 further provides that when a "taxpayer's last known address is altered due to address reorganization or standardization measures taken by the USPS or a legislative body, the [IRS] will treat the altered address as the taxpayer's new address of record." *Id.* § 4.06. The Revenue Procedure elaborates: "Examples of an address reorganization or standardization measures include the redesignation of rural route addresses as street addresses or changes to zip code boundaries." *Id*. The IRS notes, however, that "[a]ny clear and concise notification of a different address provided by the taxpayer to the Service subsequent to an address standardization or reorganization shall control over any address changes made pursuant to this section." *Id.*

For a discussion of judicial treatment of the doctrine of "clear and concise notification of a change in address," see Larry Jones & Rachel M. Michalewicz, *The Last Known Address: A Joint Effort Between the IRS and the U.S. Postal Service*, J. TAX. PRAC. & PROC., Apr.-May 2014, at 33, 34. The article explains that the Tax Court developed the requirement that the IRS exercise "reasonable diligence" in determining the taxpayer's last known address—but only if "relevant circumstances indicate that the address [the IRS previously identified] may no longer be valid." *Id.* However, the reasonable diligence standard varies by circuit, with the Fifth Circuit putting a greater burden on the IRS to track down the taxpayer's address. *See id.* at 35.

Chapter 10

§ 10.02[B] (Which Remittances Are "Payments"?)

In two fairly recent district court decisions, the courts applied facts-and-circumstances tests to determine whether a remittance was a payment, as claimed by the IRS, or a deposit, as claimed by the personal representative of an estate. In *Syring v. United States,* 2013 U.S. Dist. LEXIS 111712 at *1 (W.D. Wis. 2013), in response to the personal representative's refund request, the IRS argued the amount in question was a payment and was claimed after the limitations period had expired. *Id.* The court explained that "Upon receiving the Estate's $170,000 remittance in this case, the IRS recorded the remittance under Code 670 as a 'payment received' because the Estate did not provide a written statement designating the remittance as a deposit." *Id.* at *6.

The court applied a three-factor facts-and-circumstances test. *See id.* at *8. It found that the timing favored the taxpayer because the taxpayer made the remittance before the tax liability was defined. *Id.* at *9–10. However, the court found that the other two factors—the taxpayer's intent and the IRS's treatment of the remittance—outweighed this factor. *Id.* at *20.

The IRS's actions in treating the remittance as a payment were consistent with Revenue Procedure 2005-18, which is discussed on pages 376–77 of the text. *Id.* at *19. Regarding the taxpayer's intent, the court explained:

> A written statement designating the remittance as a deposit, as required by 26 U.S.C. § 6603 and Rev. Proc. 2005-18, is prima facie evidence that the plaintiff intended to make a deposit in submitting the money. Not only is this evidence lacking, because plaintiff did not conform to the requirements of the statutory mechanism prescribed in the tax code and the IRS regulations, the Estate's personal representative fails to offer an affidavit, declaration, or other testimony describing her intent at the time she made the payment. As such, there is no direct evidence indicating plaintiff's intent in making the remittance. The court can only derive intent from other indirect evidence.
>
> Since it is undisputed that Syring relied on the Estate's account, Roger Peterson, for advice and recommendations in making the remittance, the court must look to advice and recommendations to determine plaintiff's intent. In addition, the court will examine Peterson's actions to determine his intent in delivering his professional opinions to the plaintiff. . . .
>
> Ultimately, Peterson goes on to advise that the estimated federal estate tax will be more than $600,000 but "the full amount need not be paid at this time because the estate qualifies to *pay the tax* over the next ten years;" that the "Internal Revenue charges 2 % interest *on the unpaid taxes,* which is a low rate;" and that "the entire estimated amount of the Wisconsin state tax is being paid at

> this time” because of “the State’s high [12%] interest rate.” (Id.) Having indisputably acted promptly on this advice, no reasonable person could find plaintiff considered the remittance to be a deposit rather than a down payment on the Estate’s larger tax liability.

Id. at *11–12. The court therefore granted the IRS’s summary judgment motion. *Id.* at *21.

Similarly, in *Winford v. United States*, 970 F. Supp. 2d 548, 559 (W.D. La. 2013), *aff’d*, 587 Fed. Appx. 207 (5th Cir. 2014), a district court held that a remittance by the personal representative of an estate was an estimated tax payment and not a deposit. In that case, the court applied a six-factor test:

> (1) whether the tax has been assessed by the IRS prior to the remittance; (2) whether the remittance is “disorderly,” i.e. made without careful consideration of the potential tax liability; (3) whether the taxpayer contests liability; (4) whether the taxpayer indicates to the IRS that the remittance is a deposit; (5) whether the IRS viewed the remittance as a deposit; and, (6) whether the remittance was made when payment was due and submitted with a request for an extension of time within which to file a return.

Id. at 556 (citing Boensel v. U.S., 99 Fed. Cl. 607, 612-16 (2011)). The court found that the first factor weighed in favor of the estate, *id.*, but the other factors favored the IRS, *id.* at 556–59.

For more discussion about whether a remittance is a payment or a deposit, see Larry Jones, *Payment or Deposit?*, J. TAX PRAC. & PROC., Jun.-July 2014, at 5.

§ 10.02[B][3] (Code Section 6603)

In Chief Counsel Notice CC-2010-002, the IRS ruled that when a section 6603 deposit is applied to an assessment, only that portion of the deposit becomes a payment. The rest remains a deposit. The IRS reasoned that if the rest became a payment, the taxpayer would have to use the refund procedures to claim it. As discussed in more detail below in connection with Section 13.02[D][1], the IRS held that because the rest remains a deposit, it is not entitled to interest under Code section 6611—it is only entitled to interest under section 6603 to the extent it is attributable to a “disputable tax.”

A recent article points out that Code section 6603 and Revenue Procedure 2005-18 fail to address two important issues. *See* Michael A. Urban & Arrington Booker, *Unresolved Issues Regarding Sec. 6603 Deposits*, 44 TAX ADVISER 444 (2013). One of these issues is how to convert a deposit under section 6603 into a tax payment. *Id.*

> The second significant issue arises if a Sec. 6603 deposit is converted to a payment—either at the taxpayer’s request . . . or on the date the IRS assesses the additional tax for which the deposit was made—and some or all of the remittance

> is later returned or refunded to the taxpayer (see Rev. Proc. 2005-18, §4.02(1)).
>
> The point of contention, or at least uncertainty, is what interest rate applies to the money returned or refunded to the taxpayer, and during what period of time the interest accrues.

Id. at 445.

§ 10.02[D] (Content of the Refund Claim)

The purpose of the variance doctrine, discussed on pages 382–83 of the text, is "to ensure that the IRS is not disadvantaged in litigating issues that are different from the refund claim it considered at the administrative stage." Jeremiah Coder, *A Failed Attempt to Vary the Variance Doctrine*, 137 TAX NOTES 344, 345 (2012). In *Bayer Corp. & Subsidiaries v. United States*, No. 09-351, 2012 U.S. Dist. LEXIS 134716 (W.D. Pa. Sept. 20, 2012), the District Court explained that the IRS "demand[ed] a list of business components for the first time in this Court and then object[ed] based on the substantial variance rule to Bayer's need to gather significant, additional evidence." *Id.* at *23. The Court declined to extend the variance doctrine to these facts and held in favor of the taxpayer, explaining that it agreed with the taxpayer that "the Government 'confuses the requirement that a taxpayer disclose the *grounds* of its refund claims to the IRS with the mistaken notion that a taxpayer must disclose all of the *evidence* or subsidiary components supporting those grounds.'" *Id.* at *24 (quoting Docket No. 108, p. 2) (citations omitted).

In *Yamagata v. United States*, 114 Fed. Cl. 159 (2014), the Court of Federal Claims distinguished *Bayer* and ruled for the IRS. The issue in that case was whether an entity was taxable as a partnership or corporation, which depended on the pre-1997 regulations that included limited liability as a factor in the determination. *Id.* at 161. The taxpayer argued, in part, that the entity, "FLPJ[,] lacked limited liability because under Japanese tax law, a person who provides an essential asset to a company in which that person owns shares can be held liable for the company's delinquent taxes up to the value of (or amount of profits earned by) that asset." *Id.* at 177. The IRS asserted that this argument was barred by the variance doctrine. *Id.* The taxpayers countered that

> their "essential assets" theory did not actually constitute a new theory for relief. In support, plaintiffs note that their initial refund claims asserted that FLPJ lacked limited liability under local (i.e. Japanese) law, and the 'essential assets' theory is a component of Japanese law. In the alternative, plaintiffs suggest that the argument that FLPJ lacked limited liability under an "essential assets" theory is the equivalent to arguing that FLPJ lacked limited liability under a piercing the-corporate-veil theory, which plaintiffs timely raised in their administrative tax refund proceedings.

Id.

The court agreed with the IRS because the claim for refund did not put the IRS on notice about the "essential assets" theory and the taxpayers had not presented the IRS with the factual basis of that theory. *Id.* at 178. The court distinguished *Bayer* as "stand[ing] for the proposition that a plaintiff's failure to provide all relevant facts or evidence as part of the initial administrative claim does not automatically violate the substantial variance rule. In contrast to [the taxpayers in the present case], the plaintiffs in those cases put the IRS on notice of both the subsidiary legal theories and the additional facts that had not been part of their original administrative refund claims. Thus, both are distinguishable from the case at bar." *Id.* at 178 n.34.

Cencast Servs, L.P. v. United States, 729 F.3d 1352 (Fed. Cir. 2013), also raised a variance issue, but focused on exceptions to the variance doctrine. The question in that case was whether the taxpayer's independent contractor theory substantially varied from its refund claim. *Id.* at 1367. The court stated, "[t]here is no dispute that the independent contractor theory was not raised in Cencast's 2002 administrative refund claim. There is also no doubt that the independent contractor theory substantially varies from Cencast's original theory of the case (which was based on [a] wage cap issue . . .). However, Cencast argues that exceptions to the variance rule apply here." *Id.*

The two exceptions the taxpayer raised were the equitable recoupment and waiver doctrines. *Id.* at 1367–68. However the court found that neither applied:

> [W]here the government files a counterclaim that places the entire balance of assessed tax in issue, we agree with the Claims Court that Cencast's right to assert a setoff with respect to the government's counterclaim recovery "exists only when the Government raises a new issue that the plaintiff could not have anticipated and, therefore, could not have . . . asserted as grounds for its [original] refund [claim]." . . . No new and inconsistent theories were raised by the government in its counterclaims. Accordingly, the equitable recoupment exception is inapplicable.
>
> Cencast next argues that the waiver doctrine saves its independent contractor theory. Under this doctrine, where "the taxpayer files a timely formal claim but fails to include the specific claim for relief [i.e., the independent contractor theory], th[at] claim may nonetheless be considered timely if the IRS considers that specific claim within the limitations period." . . .
>
> Here, it is clear that, before the expiration of the limitations period, the IRS neither "consider[ed]" nor made a "determination of the merits" as to the scope or nature of any independent contractor overpayment.

Id. (citations omitted).

In *El Paso CGP Co., v. United States*, 748 F.3d 225, 229 (5th Cir. 2014), the Fifth Circuit held that the variance doctrine did not apply to bar a taxpayer's refund suit where the IRS's actions created the variance. In that case, the taxpayer made a refund claim in 2002 that was addressed in a closing agreement in 2005. *Id.* at 227. The IRS paid part of the refund but withheld part of it to cover deficiencies for other years. *Id.* In 2006, the taxpayer sent the IRS a memorandum claiming that the IRS had failed to assess the deficiencies before the statute of limitations expired and therefore was barred from using its refund offset power.[15] *Id.* Instead, the taxpayer argued, the IRS had to use the statutory mitigation provisions, and it was too late to do that. *Id.* The IRS denied what it considered an informal claim for refund. *Id.* The taxpayer then filed a refund suit. *Id.*

The district court entered summary judgment for the IRS on the ground that the court lacked jurisdiction over the case. *Id.* at 228. The district court reasoned in part that the taxpayer must make a refund claim as a prerequisite to district court jurisdiction and that the taxpayer's 2002 refund claim did not qualify because the 2005 closing agreement resolved it. *Id.*

> As an alternative jurisdictional ground for dismissal of the refund suit, the magistrate judge suggested that the district court lacked jurisdiction because El Paso's suit contravened the variance doctrine. To assert a court's jurisdiction over a claim for refund, the variance doctrine requires that the grounds for recovery advanced in federal court must be the same as advanced before the IRS. The magistrate judge concluded that the grounds for recovery presented in federal court arose from the IRS's set-off, an act that occurred three years *after* the filing of El Paso's Refund Claim before the IRS. Thus, El Paso's Refund Claim could not have rested on the same grounds for recovery as the federal suit because those grounds for recovery had not occurred at the time of the Refund Claim.

Id. (emphasis in original).

On appeal, the Fifth Circuit rejected the variance argument because the actions the taxpayer objected to occurred in 2005, which the taxpayer could not have been expected to anticipate in its 2002 refund claim. *Id.* at 229. However, the Court of Appeals found in favor of the IRS on the mitigation provisions issue and thus affirmed the district court. *Id.* at 233.

§ 10.02[E] (Informal Claims for Refund)

In an unpublished opinion, a district court found that "oral and written communications to the IRS. . . [and] submission of the Will with the Original tax return, which made it clear in Item III that charitable bequests should not be charged taxes" constituted an informal claim that was

[15] Refund offsets—IRS use of an overpayment to pay another tax liability—are discussed further in Section 13.04.

later perfected by the filing of an amended return. *Wilshire v. U.S.*, 2008 U.S. Dist. LEXIS 91920 (S.D. Ohio Nov. 10, 2008). The court explained:

> Here the IRS had sufficient information to make a reasonable investigation and evaluation of the Estate's claim based on the submission of the Will and [Executor Philip] Blomer's notations on the Original Return relating to the taxes on charitable bequests. . . . Blomer's May 21, 2003 letter, which he mailed during the limitations period, clearly referred to charitable bequest taxes and requested a refund. Although the accountants hired by the Estate improperly prepared the returns, the IRS had the Will in its possession, was instructed by the Estate of the proper interpretation of the Will and calculation of the taxes, received the Estate's request for a refund, and conducted an extensive audit. Under these facts and circumstances there is no doubt the IRS was on notice the Estate asserted a right with respect to an overpayment of tax. Taken together, Blomer's oral and written communications constitute a valid informal claim for a refund. Estate of Tinari v. U.S., No. 97-1974, 1998 U.S. Dist. LEXIS 14945, 1998 WL 720156 (E.D. Pa. Sept. 15, 1998).

Id. at *11–12. The court further noted that it found "troubling the fact that Defendant [IRS] purged its file after the Estate gave it notice of the refund claim, and concludes a negative inference is warranted against the IRS for spoliation." *Id.* at *12.

By contrast, in *Greene-Thapedi v. United States*, 549 F.3d 530 (7th Cir. 2008),[16] the Court of Appeals for the Seventh Circuit denied an informal refund claim as never having been perfected. In that case, the informal claim was a district court complaint. *Id.* at 532. The taxpayer never followed up with a formal refund claim, so the district court lacked subject matter jurisdiction over the case. *Id.* at 533. *See also* Pennoni v. United States, 86 Fed. Cl. 351, 362(2009) (taxpayer's fax and phone calls constituted an informal claim, but the court lacked jurisdiction over the case because the taxpayer never followed up with a formal claim).

The Court of Appeals for the Tenth Circuit discussed the informal claim doctrine in *Dzula v. United States*, 349 F. App'x. 335, 338–39 (2009). According to that court:

> There are three components to an informal claim; a claim must: (1) "provide the . . . IRS with notice that the taxpayer is asserting a right to a refund"; (2) "describe the legal and factual basis for the refund"; and (3) "must have some written component." *New England Elec. Sys. v. United States*, 32 Fed. Cl. 636, 641 (Fed. Cl. 1995)."

Id. at 339. The court rejected the taxpayer's appeal to the informal claim doctrine because the taxpayer's claim did not satisfy the second component. *Id.*; *see also* Palomares v. Commissioner, T.C. Memo. 2014-243, 2014 Tax Ct. Memo LEXIS 241 (Form 8379 (injured

[16] A related proceeding in the case, *Greene-Thapedi v. Commissioner*, 126 T.C. 1 (2006), is discussed in the opinion reproduced in Chapter 16 of the text, starting on page 652. The opinion reproduced in Chapter 16 discusses a Collection Due Process issue.

spouse allocation) did not constitute an informal refund claim); Edwards v. United States, 92 Fed. Cl. 277 (2010) (denying the government's motion to dismiss on the grounds that the taxpayer's extensions of time to file on Form 4868 could have been sufficient to constitute informal refund claims).

The Court of Appeals for the Second Circuit discussed informal and protective refund claims in *Ambase Corp. v. United States*, 731 F.3d 109 (2d Cir. 2013). The Second Circuit applied the same test that the Tenth Circuit did in *Dzula*, also quoting *New England Elec. Sys. v. United States*, 32 Fed. Cl. 636, 641 (Fed. Cl. 1995). The court then affirmed the District Court's holding "that it had subject-matter jurisdiction based on a 1996 formal protective claim" that addressed the relevant issues. *Id.* at 119–20.

The Court of Appeals for the Fifth Circuit has articulated a somewhat different test for informal refund claims. *See* BNSF Ry. Co. v. United States, 745 F.3d 774, 785 (5th Cir. 2014). According to that court, "'an informal claim is sufficient if it is [1] filed within the statutory period, [2] puts the IRS on notice that the taxpayer believes an erroneous tax has been assessed, and [3] describes the tax and year with sufficient particularity to allow the IRS to undertake an investigation.'" *Id.* (quoting PALA, Inc. Emp. Profit Sharing Plan & Trust Agreement v. United States, 234 F.3d 873, 877 (5th Cir. 2000)). The Fifth Circuit also explained that the informal claim doctrine rests on the idea that the taxpayer will follow up with a claim that corrects the deficiencies in the original claim. *Id.* In that case, the court found that the taxpayer failed to perfect its informal claims, so it dismissed the refund claims.[17] *Id.*

For further reading on the informal claim doctrine, including its origins and history, see, *e.g.*, John Keenan & Andrew Brewster, *Treating a Refund Request Made on an Incorrect Form as an Informal Claim*, 46 TAX ADVISER 168 (2015); William A. Neilson, *Informal Claims for Refund—A Winding Road*, 26 AKRON TAX J. 147 (2011). For further discussion of the *Edwards* case and an argument that the general six-year statute of limitations for suits against the government in 28 U.S.C. section 2401 should provide an "outside limit" for tax refund suits, see Adam R.F. Gustafson, *An "Outside Limit" for Refund Suits: The Case Against the Tax Exception to the Six-Year Bar on Claims Against the Government*, 90 OR. L. REV. 191 (2011). The Gustafson article also critiques *Wagenet*, which is discussed below. *See id.* at 234–37.

§ 10.03[A][1] (Limitations Periods)

Some controversy has arisen over the question of what the deadline is for the taxpayer to file a refund suit if the IRS fails to disallow a refund claim. As explained in the text on page 388, the two-year limitations period in Code section 6532 does not begin until the IRS mails the taxpayer a notice of disallowance (or the taxpayer waives notice). This could make the limitations period unlimited. The issue is whether another federal statute may impose a deadline.

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[17] BNSF filed a petition for rehearing, which the Fifth Circuit granted. 775 F.3d 743 (5th Cir. 2015). On rehearing, the Fifth Circuit reversed and remanded the case on different grounds, *id.* at 758–60, but affirmed its prior ruling that the refund claims were unperfected and thus were dismissed, *id.* at 757–58.

In *Wagenet v. United States*, 2009-2 U.S. Tax Cas. (CCH) ¶50,766, 2009 U.S. Dist. LEXIS 115547 (C.D. Cal. Sept. 14, 2009), the taxpayer had filed a refund claim in 1988. The IRS never sent the taxpayer a Notice of Disallowance, and, in 2008, the taxpayer filed a refund suit. *Id.* The government argued that 28 U.S.C. section 2401, the statute of limitations in the Tucker Act, which provides that "every civil action commenced against the United States shall be barred unless the complaint is filed within six years after the right of action first accrues" barred the taxpayer's suit. *Id.* at *4. The court held that Code section 6532(a)(1) "is silent concerning refund actions where there is no notice of disallowance," so that section did not apply. *Id.* Thus, the six-year period of 28 U.S.C. section 2401 applied. *Id.* at *7.

The court further held that the taxpayer's "action accrued six months after [he] filed his administrative claim." *Id.* at *6. The taxpayer's refund suit, which was filed 20 years after his refund claim, was therefore too late. *Id*. In holding the taxpayer's claim time-barred, the court found that *Detroit Trust Co. v. United States*, 130 F. Supp. 815 (Ct. Cl. 1955), was wrongly decided and that other cases were distinguishable. *See id.* at *8–9.

In Chief Counsel Notice CC-2012-012 (June 1, 2012), *available at* http://www.charitableplanning.com/cpc_1950117-1.pdf, the IRS moved away from *Wagenet* and similar cases. In the Notice, the IRS took the following position:

> Although favorable to the government, the holdings regarding the application of 28 U.S.C. § 2401 to refund suits brought under section 7422 are inconsistent with Rev. Rul. 56-381 and the decisions cited therein that reject the argument that six-year periods of limitation in either 28 U.S.C. § 2401 or 2501 apply to bar tax refund suits. . . . Congress has supplanted the catch-all limitation period provided for in 28 U.S.C. §§ 2401 and 2501 with a specific period of limitation in section 6532 that governs tax refund suits.
>
> Chief Counsel attorneys must continue to follow Rev. Rul. 56-381 and should advise the Service or the Department of Justice that the general six-year period of limitation for bringing claims against the government in 28 U.S.C. §§ 2401 and 2501 does not apply to tax refund suits. . . . When the Service has not issued a notice of claim disallowance and the taxpayer has not waived notice, the taxpayer may file a refund suit anytime after the initial six-month period provided in section 6532(a).

Id. at 2 (citations and footnote omitted). The IRS also stated in the Internal Revenue Manual: "The Service and the Department of Justice should be advised that the general six-year period of limitation for bringing claims against the government in 28 U.S.C. §§ 2401 and 2501 does not apply to tax refund suits." IRM 34.5.2.2(5) (revised Dec. 21, 2012).

In November 2012, in a non-tax case, the U.S. Supreme Court addressed the question of when the Tucker Act, which addresses claims against the United States, applies despite the terms of a more specific statute. *See* United States v. Bormes, 133 S. Ct. 12 (2012). Previously, the

Court had also ruled that a tax-refund-specific limitation period, limiting the refund to amounts paid within the previous four years, overrode the general six-year statute of limitations under the Tucker Act. *See* United States v. A.S. Kreider Co., 313 United States 443, 446–48 (1941). Also, in *United States v. Clintwood Elkhorn Mining Co.*, 553 U.S. 1, 4 (2008), the Court held that taxpayers who paid a coal tax later found to be an unconstitutional violation of the Export Clause, had to file timely refund claims under the applicable Code provisions, rather than being subject to the more lenient provisions of the Tucker Act.

In *Bormes*, the Court stated, "[t]he Tucker Act is displaced . . . when a law assertedly imposing monetary liability on the United States contains its own judicial remedies. In that event, the specific remedial scheme establishes the exclusive framework for the liability Congress created under the statute." *Id.* at 18. The Court also noted that "Our more recent cases have consistently held that statutory schemes with their own remedial framework exclude alternative relief under the general terms of the Tucker Act." *Id.* In a subsequent decision, the Supreme Court further held: "To determine whether a statutory scheme displaces Tucker Act jurisdiction, a court must 'examin[e] the purpose of the [statute], the entirety of its text, and the structure of review that it establishes.'" Horne v. Dep't of Agriculture, 133 S. Ct. 2053, 2062–63 (2013) (quoting United States v. Fausto, 484 U.S. 439, 444 (1988)). In both cases, the Court held that the more specific statute applied and the Tucker Act did not. *See id.* at 2063 ("These statutory provisions [under the Agricultural Marketing Agreement Act (AMAA)] afford handlers a ready avenue to bring takings claim against the USDA. We thus conclude that the AMAA withdraws Tucker Act jurisdiction over petitioners' takings claim. Petitioners (as handlers) have no alternative remedy . . . ."); *Bormes*, 133 S. Ct. at 19–20 ("The Federal Circuit was . . . wrong to conclude that the Tucker Act justified applying a 'less stringent' sovereign-immunity analysis to FCRA [Fair Credit Reporting Act] than our cases require. . . . [W]hether or not FCRA contains the necessary waiver of immunity, any attempt to append a Tucker Act remedy to the statute's existing remedial scheme interferes with its intended scope of liability.").

One article explained that,"[i]f the *Clintwood Elkhorn* decision is read with the *Bormes* standard in mind, it seems clear that the Court considered the tax provisions as a 'detailed remedial scheme' separate and distinct from a general claim against the United States under the Tucker Act." Mary Monahan & Victoria O'Connor, *"Outside Limit" on Tax Refund Suits After* Bormes, 140 TAX NOTES 1589, 1594 (2013). The article further argues:

> Under the reasoning of *Bormes*, a strong case can be made that the general Tucker Act provisions are rendered inapplicable by the statutory framework for refund suits provided in sections 7422, 6511, 6532, and 28 U.S.C. section 1346(a)(1). Although the *Bormes* decision seemingly answers whether the general Tucker Act statute of limitations applies to refund suits when a disallowance notice has not been issued, because the Tucker Act statute is jurisdictional, taxpayers with pending refund claims approaching the 6 1/2-year mark would still be well advised to file suit as a protective measure.

Id. at 1589.

§ 10.03[A][2] (Refund Litigation in the United States District Courts)

On page 388 of the text, U.S. Tax Court Rule 20(d), not 20(b), provides the $60 fee for filing a Tax Court petition. *See* U.S. Tax Ct. R. 20(d) (as amended through July 6, 2012).

In *Ford Motor Co. v. United States*, 134 S. Ct. 510 (2013), the U.S. Supreme Court considered a possible application of the Tucker Act, which was discussed briefly in Section 10.03[A][1] of this Supplement. In *Ford Motor Co.*,

> after the Internal Revenue Service advised Ford Motor Company that it had underpaid its taxes from 1983 until 1989, Ford remitted a series of deposits to the IRS totaling $875 million. . . . Later, Ford requested that the IRS treat the deposits as advance payments of the additional tax that Ford owed. Eventually the parties determined that Ford had overpaid its taxes in the relevant years, thereby entitling Ford to a return of the over-payment as well as interest. But the parties disagreed about when the interest began to run under 26 U. S. C. §6611(b)(1). Ford argued that "the date of overpayment" was the date that it first remitted the deposits to the IRS. Ibid. The Government countered that the date of overpayment was the date that Ford requested that the IRS treat the remittances as payments of tax. The difference between the parties' competing interpretations of § 6611(b) is worth some $445 million.

Id. at 510.

After the District Court and the Court of Appeals for the Sixth Circuit both ruled in favor of the government, the taxpayer petitioned for certiorari, arguing that the Court of Appeals was incorrect to construe Code section 6611 in favor of the Government. *Id.* The taxpayer argued that "it is 28 U. S. C. §1346—not §6611—that waives the Government's immunity from this suit, and §6611(b) is a substantive provision that should not be construed strictly." *Id.* 28 U.S.C. section 1346(a)(1) is the provision giving the district courts and Court of Federal Claims concurrent jurisdiction over "[a]ny civil action against the United States for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or any penalty claimed to have been collected without authority or any sum alleged to have been excessive or in any manner wrongfully collected under the internal-revenue laws . . . ." However, in response to the taxpayer's certiorari petition, the government argued that section 1346(a)(1) did not apply to the case and that the Tucker Act, 28 U.S.C. section 1491(a)(1), provided the only source of jurisdiction and general waiver of sovereign immunity. *Id.*

Because the government had not raised the Tucker Act issue until it responded to the petition for certiorari, the Supreme Court remanded the case to the Sixth Circuit to consider the issue. *Id.* at 510–11. 28 U.S.C. § 1491(a)(1) provides in part, "The United States Court of Federal Claims shall have jurisdiction to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort." Therefore, the Supreme Court noted that if the Tucker Act applies, jurisdiction existed only in the Court of Federal Claims. *Id.* at 510.

On remand, the IRS acknowledged that its jurisdiction argument was contrary to the Sixth Circuit precedent in *E.W. Scripps Co. v. United States*, 420 F.3d 589 (6th Cir. 2005), which had held that "§ 1346(a)(1) confers jurisdiction on the federal district courts to adjudicate claims for overpayment interest because the term 'recovery of any sum' in that statute includes suits to obtain overpayment interest." *Ford Motor Co.*, 768 F.3d 580, 583–84 (2014) (quoting *Scripps*, 420 F.3d at 597). The court declined to reconsider *Scripps* but held in favor of the IRS on the merits, determining that the government was not required to pay interest on Ford's deposit until the date Ford requested that its deposit be converted into an advance payment. *Id.* at 588–89. The Supreme Court denied Ford's subsequent petition for certiorari. *Ford Motor Co. v. United States*, No. 14-1085, 2015 U.S. LEXIS 4225 (June 22, 2015). The *Ford Motor* case is also discussed in Section 13.02[D][1] of this Supplement.

§ 10.03[A][3] (Refund Litigation in the Court of Federal Claims)

On page 390 of the text, the citation to U.S. Court of Federal Claims Rule 7 should be changed to Rule 12, which states, "If the answer contains a counterclaim, offset, or plea of fraud, a party must file an answer to the counterclaim, and may file a reply to the offset or plea of fraud, within 21 days after being served with the answer." U.S. Ct. Fed. Cl. R. 12(a)(1)(B) (as amended through Jan. 11, 2010).

The citation to U.S. Ct. Fed. Cl. R. 77(e) on the same page should be deleted. *See* Rules of the United States Court of Federal Claims (as amended through Jan. 11, 2010).

§ 10.03[A][4] (The "Full Payment" Rule)

For a proposal for a statutory hardship exception to *Flora*, see Carlton M. Smith, *Let the Poor Sue for a Refund Without Full Payment*, 125 TAX NOTES 131 (2009).

In Legal Memorandum 201315017, *available at* 2013 TAX NOTES TODAY 72-23, the IRS found that the penalties under Code sections 6721 (failure to file a correct information return) and 6722 (failures to furnish a correct payee statement) are divisible. Accordingly, "[a] taxpayer assessed with a penalty under either of these sections need only pay the divisible amount of the penalty attributable to a single failure, or $100 under the general rule, before filing a refund claim and instituting a refund suit under section 7422." *Id.*

§ 10.05 (Statutes of Limitations on Refund Claims)

In *Maine Med. Ctr. v. United States*, 675 F.3d 110 (1st Cir. 2012), the IRS claimed it did not receive the taxpayer's refund claim, and the taxpayer's employees had no recollection or proof of mailing, although they had prepared to file the claim on the date it was due. The court considered the possible application of Code section 7502(a), but found that it was of no help to the taxpayer. The court explained:

> Most courts hold that a taxpayer must show eventual actual delivery, even if it is after the expiration of the statute of limitations, if that taxpayer is to take advantage of the benefits of § 7502(a). . . . This analysis is consistent with the plain language of the statute, which requires that the relevant document be "delivered by the United States mail." 26 U.S.C. § 7502(a)(1); *see also* Me. Med. Ctr., 766 F. Supp. 2d at 260 (stating that "the essential requirement" of § 7502(a), according to its plain language, is actual delivery) (quoting Estate of Wood v. Comm'r, 909 F.2d 1155, 1162 (8th Cir. 1990) (Lay, C.J., dissenting)). As the IRS has asserted that it has no record of receiving MMC's 2001 refund claim, MMC must find some way to overcome this difficult hurdle.
>
> MMC argues that it need not show actual delivery because it can prove, via extrinsic evidence, that its refund claim had a timely postmark. The Eighth and Ninth Circuits have endorsed this method of satisfying § 7502. *See* Anderson v. United States, 966 F.2d 487, 491 (9th Cir. 1992) (holding that "direct" extrinsic proof of postmark is permissible for purposes of § 7502 and that § 7502 does not supplant use of common law mailbox presumption); *Wood*, 909 F.2d at 1161 (same). There are a number of reasons why this argument does not help MMC. First, the circuits that do allow the use of extrinsic evidence generally only do so for purposes of invoking an "intra-§ 7502 mailbox rule," Phila. Marine, 523 F.3d at 149 (internal quotation marks omitted), which is not available to MMC because its refund request, allegedly mailed on the deadline, would not have arrived by that deadline in the ordinary course of post office business. Second, extrinsic evidence has only been used to prove a postmark, or at the very least, actual mailing; MMC offers no evidence whatsoever of the mailing itself and thus fails to provide the necessary level of proof. Third, recent regulations appear to foreclose the possibility of the use of extrinsic evidence for purposes of satisfying the requirements of § 7502.

Id. at 115–16 (citations omitted).

With respect to the new regulations, the court explained:

> [T]he IRS has issued regulations interpreting § 7502 that would appear to foreclose the use of extrinsic evidence as a means of proving a timely postmark. *See* 26 C.F.R. § 301.7502-1(e) (2011). The regulations lay out a general rule that § 7502 requires actual delivery, 26 C.F.R. § 301.7502-1(e)(1), and that the exclusive exceptions to the rule are "proof of proper use of registered or certified mail, and proof of proper use by a duly designated [private delivery service]," *id.* § 301.7502-1(e)(2). The regulations further emphasize the exclusivity of the exceptions, stating that "[n]o other evidence of a postmark or of mailing will be

> prima facie evidence of delivery or raise a presumption that the document was delivered." *Id.*

Id. at 118 (footnotes omitted). The regulations were effective on August 23, 2011. *See Final Regs Explain How to Prove Delivery of Tax Documents Absent Direct Proof*, 2011 TAX NOTES TODAY 162-12 (Aug. 22, 2011).

When the IRS offsets a taxpayer's liability with a refund from another year, a question arises as to when that liability was "paid" for purposes of the statute of limitations on refund claims. *See* Michael A. Urban, *When Do Sec. 6402 Offsets Trigger the Refund Limitation Period*, 44 TAX ADVISER 478, 478 (2014). One possibility is the date when the IRS applied the refund to the taxpayer's account. *Id.* An alternative approach, which the Internal Revenue Manual adopts, is to make the date of payment the day on which the IRS *authorizes* the refund to be applied to the taxpayer's account. *Id.* at 478–79. This approach relies on Code sections 7422(d) and 6407, but has been criticized by the Ninth Circuit. *See id.*

§ 10.05 [C] (Statutes of Limitations on Refund Claims Applicable in Tax Court Cases)

For an example of how to apply the special limitation periods in section 6512(b)(3), see *Butts v. Commissioner*, T.C. Memo. 2015-74, 2015 Tax Ct. Memo LEXIS 100 (finding that a two-year lookback period applied under section 6512(b)(3)(B) and, therefore, the court lacked jurisdiction to order a refund of taxes paid on April 15, 2008, which was more than three years before the notices of deficiency were mailed).

§ 10.05[D][1] (Applying Sections 6511 and 6512 to Delinquent Returns)

In *Petty v. Commissioner*, T.C. Memo. 2010-63, 2010 Tax Ct. Memo LEXIS 60,, the taxpayer received an extension of time to file a return for tax year 2004, extending the due date to August 15, 2005. The taxpayer failed to file her return until November 7, 2008, nearly three months *after* she received a notice of deficiency (August 11, 2008). She filed a refund claim on November 17, 2008. Applying *Commissioner v. Lundy*, 516 U.S. 235 (1996) and *Zarky v. Commissioner*, 123 T.C. 132 (2004) (reproduced in the text), the Tax Court determined that the taxpayer's claim was barred by the look-back provision in section 6512(b)(3)(B) because the taxpayer's withholding and credits for 2004 were deemed paid on April 15, 2005. Because the notice of deficiency serves as the date taxpayer filed a claim for refund, the proper look-back period included any payments made by taxpayer within three years of August 11, 2008. Since the taxpayer's payments were made before that time, on April 15, 2005, she was not entitled to claim a refund.

§ 10.05[E] (Tolling of Statutes of Limitations on Refund Claims)

In *Walter v. United States*, 2010-1 U.S. Tax Cas. (CCH) ¶50,136, 2009 U.S. Dist. LEXIS 117166 (W.D. Pa. Dec. 16, 2009), the court held that a technical deficiency in a physician's statement that is easily corrected is sufficient to meet Code section 6511(h). In *Walter*, the physician's letter did not explicitly state that the taxpayer's physical impairment prevented him from managing his financial affairs and did not contain a certification. *Id.* at *28. The court found that the "clear import of [the physician's] letter was that [taxpayer's] clinical depression prevented him from managing his financial affairs: it stated, inter alia, that 'the depression results in inertia which often prevents him from performing the simplest everyday tasks such as answering the telephone.'" *Id.* at *28. The court also found that "[t]he letter also provided no reason to conclude that [the physician] would not certify that he was giving a true, accurate and complete description of the [taxpayer's] condition." *Id.*

In *Murdock v. United States*, 103 Fed. Cl. 389 (2012), the Court of Federal Claims held that the suspension period under Code section 6511(h) cannot include periods after the taxpayer's death. The court relied on the plain language of the statute, stating:

> Ms. Murdock contends that the tolling period should extend beyond her father's death until the time she discovered the unfiled tax returns in January 2009. As the statute specifies, however, the period of tolling may only "be suspended during any period of *such individual's life* that such individual is financially disabled." I.R.C. § 6511(h)(1) (emphasis added). . . . Thus, if the financially disabled taxpayer is no longer alive, Subsection 6511(h) can no longer apply and the statutory clock must begin to run. *See United States v. Locke*, 471 U.S. 84, 93 . . . (1985) ("[W]ith respect to filing deadlines a literal reading of Congress' words is generally the only proper reading of those words.").

Id. at 395.

In *Williams v. United States*, 2013 U.S. Dist. LEXIS 113837 at *11 (S.D. Tex. Aug. 13, 2013), a federal district court ruled that "The taxpayer's own opinion that he or she suffered a financial disability does not satisfy the procedural requirements of Revenue Procedure 99-21." The court noted that the taxpayer had failed to submit a doctor's note, as required by the Revenue Procedure. *Id.* at *10.

In another case, the Court of Appeals for the Federal Circuit denied the taxpayer's claimed financial disability under Code section 6511(h) where his doctor did not specifically state that the taxpayer's Menière's disease and resulting depression had prevented him from managing his financial affairs. Redondo v. United States, 542 Fed. Appx. 908, 910–11 (Fed. Cir. 2013). The court explained that the doctor's written statement failed to comply with Revenue Procedure 99-21 because "[t]he Court of Federal Claims found that [the doctor] . . . failed to specifically state that Mr. Redondo was 'prevented' from managing his financial affairs, and failed to indicate a specific time period during which Mr. Redondo was unable to tend to his financial affairs" as well as failing to include a signed certification. *Id.*

For more on the requirements under Code section 6511(h), see T. Keith Fogg & Rachel E. Zuraw, *Financial Disability For All*, 62 CATH. U. L. REV. 965 (2013) (arguing for broader equitable relief from the statute of limitations on refund claims).

§ 10.05[F][2] (Equitable Recoupment)

As discussed in Section 8.09 above, the Tax Court applied post-amendment section 6214(b) in *Menard, Inc. v. Commissioner*, 130 T.C. 54 (2008), interpreting the amendment broadly:

> When Congress recently amended section 6214(b), it confirmed in the broadest of terms our authority to apply the doctrine of equitable recoupment. . . . If, as respondent suggests, Congress intended to limit the scope of the Court's equitable recoupment authority to taxes that normally fall within the Court's deficiency and/or overpayment jurisdiction, we are convinced that Congress would have drafted section 6214(b) to say so in clear and unambiguous terms.

Id. at 66.

In *Karagozian v. Commissioner*, T.C. Memo. 2013-164, 2013 Tax Ct. Memo LEXIS 167, the Tax Court held that the equitable recoupment doctrine did not apply because the case did not involve a single transaction or event that was treated inconsistently under two tax regimes. *Id.* at *14. The court explained:

> Petitioner would like to use overpaid FICA taxes for tax years 2002 through 2007 to offset his tax deficiency for 2008. Although the taxes petitioner paid in the time-barred years were paid on the same type of transaction (i.e., compensation petitioner received from Coty [his former employer]) as in 2008, we follow the Supreme Court's reasoning in *Elec. Storage Battery Co.* [, 329 U.S. 296 (1946)] and find that the overpaid FICA taxes from 2002 through 2007 are separate transactions, separate items, and separate taxable events from petitioner's 2008 tax deficiency. Income taxes are levied on an annual basis. Each year is the origin of a new liability and of a separate course of action.

Id. at *13. Not surprisingly, the Second Circuit affirmed the Tax Court. *Karagozian v. Commissioner*, 595 Fed. Appx. 87, 88 (2nd Cir. 2015).

Chapter 11

§ 11.03 (CHOICE OF FORUM)

For additional reading on forum choice in federal tax cases, see Gerald A. Kafka, *Choice of Forum: Nontraditional Factors*, *in* HANDLING A TAX CONTROVERSY: AUDIT, APPEALS, LITIGATION & COLLECTIONS (2014); *see also* Michael J. Desmond & Kathleen Pakenham, *Commencement of a Deficiency Proceeding and Pretrial Practice*, 29 PRAC. TAX LAW. 21 (2015); Gerald A. Kafka, *Choice of Forum* in Federal Civil Tax Litigation (Part 1), 25 PRAC. TAX LAW. 55 (2011), *available at* http://files.ali-cle.org/thumbs/datastorage/lacidoirep/articles/PTXL1102_Kafka_thumb.pdf. For more information on the jurisdiction of the Tax Court, District Court, and Federal Court of Claims, see A. Lavar Taylor, *Court Jurisdiction: It's Not Just for Law Professors*, J. TAX PRAC. & PROC., Dec. 2014-Jan. 2015, at 31.

§ 11.04 (THE BURDEN OF PROOF IN TAX CASES)

On page 423 of the text, the citation to *Vogt v. Commissioner* contains a typo. It should be T.C. Memo. 2007-209.

§ 11.04[A] (Code Section 7491)

In *Simpson v. Commissioner*, 141 T.C. 331 (2013), the Tax Court held that where the taxpayers conceded at trial that they bore the burden of proof but sought to shift the burden in their post-trial brief, the burden of proof remained on them because the request was untimely. *Id.* at 339. The court stated, "At a minimum, respondent has not been afforded an opportunity to test petitioners' allegations, either by cross-examination or by producing evidence, that petitioners have complied with the substantiation and recordkeeping requirements under section 7491(a)(2)." *Id.*

§ 11.04[B] (Does the Burden of Proof Matter?)

In *Knudsen v. Commissioner*, T.C. Memo. 2007-340 (2007), 2007 Tax Ct. Memo LEXIS 376, *opinion supplemented on denial of reconsideration*, 131 T.C. 185 (2008), the Tax Court held that the taxpayers' "exotic animal breeding activity . . . was not an activity engaged in for profit within the meaning of [Code] section 183." *Id.* at *46. To reach this conclusion, the court applied the "nonexclusive list of factors [in Treasury Regulation 1.183-2(b)] . . . considered in determining whether a taxpayer ha[d] [a] requisite profit objective." *Id.* at *25. The court therefore disallowed certain deductions relating to the taxpayers' breeding activity. *Id.* at *21.

The court also determined that it need not decide whether section 7491 applied because "[t]he outcome of this case is based on a preponderance of the evidence and thus is unaffected by section 7491." *Id.* at *22. However, the taxpayers filed a motion requesting that the court "reconsider whether they satisfied the requirements under section 7491(a) to shift the burden of proof . . . ." Knudsen v. Commissioner, 131 T.C. 185, 185 (2008). Specifically, the taxpayers claimed that "(1) [the] Court erred in concluding that [it] did not need to decide whether petitioners met the requirements under section 7491(a) to shift the burden of proof to respondent, and (2) each factor under section 1.183-2(b) . . . is a separate 'factual issue' within the meaning of section 7491(a)." *Id.* at 186.

The Tax Court rejected the taxpayers' argument on the first issue, stating:

> At least two other Courts of Appeals have . . . held that the burden of proof shift under section 7491(a) is relevant only when there is an evidentiary tie. *See* Geiger v. Comm'r, 279 Fed. Appx. 834, 835 (11th Cir. 2008) ("any error committed by the tax court by failing to shift the burden was harmless, because the burden of proof is of practical consequence only in the rare event of an evidentiary tie"), *affg.* T.C. Memo. 2006-271; FRGC Inv., LLC v. Comm'r, 89 Fed. Appx. 656 (9th Cir. 2004) (the Court was not required to determine who had the burden of proof under section 7491(a) when the preponderance of the evidence favored the Commissioner), *affg.* T.C. Memo. 2002-276.

Id. at 189 (emphasis added).

The court agreed with the analysis of the Court of Appeals for the Eighth Circuit in *Blodgett v. Commissioner,* 394 F.3d 1030 (8th Cir. 2005), concluding that "[i]n a case where the standard of proof is preponderance of the evidence . . . , [the court] may decide the case on the weight of the evidence and not on an allocation of the burden of proof." *Id.* The court found in *Knudsen* that "the weight of the evidence favored [the IRS], and consequently, [it] did not need to decide the allocation of the burden of proof under section 7491(a) with respect to the section 183 issue." *Id.*

The court refused to address the taxpayers' second argument—that each factor under regulation section 1.183-2(b) is a separate "factual issue" within the meaning of 7491(a)—noting that this legal question was not raised at the original trial and "reconsideration is not the appropriate forum for . . . new legal theories. . . ." *Id*. at 190. Moreover, the court found that the allocation of the burden of proof would still have been irrelevant even if it had applied section 7491 factor by factor. *Id.* at 191 n.7. The taxpayers had "not introduce[d] evidence . . . to show that the requirements of sec. 7491(a) were satisfied with respect to each factor." *Id.*

In *Rosenfeld v. Commissioner,* the Tax Court followed the same approach to the burden of proof that it had taken in Knudsen, citing that case and *FRGC Inv., LLC v. Commissioner,* 89 F. App'x. 656 (9th Cir. 2004). The Tax Court stated, "where the standard of proof is based on a preponderance of the evidence, as it is here, the Court may decide the case on the weight of the evidence and need not decide it on an allocation of the burden of proof." *Rosenfeld v. Commissioner*, T.C. Memo. 2011-110, 2011 Tax Ct. Memo LEXIS 109, *7, *aff'd*, 537 Fed. Appx. 697 (9th Cir. 2013); *see also* FRGC Inv., LLC v. Commissioner, 89 F. App'x. 656 (9th Cir. 2004).

In *Esgar Corp. v. Commissioner*, 744 F.3d 648, 654 (10th Cir. 2014), the Court of Appeals for the Tenth Circuit applied the reasoning of *Blodgett*, holding "Section 7491 does not require an express burden shift when both parties produce evidence and the preponderance favors one party over the other." It also found itself powerless to "reweigh the evidence" to see if the preponderance did favor the IRS, as the Tax Court had found. *Id.* The court stated, "The Tax Court's finding—that the weight of the evidence favored agriculture as the properties' highest and best use—will therefore stand 'if it is supported by substantial evidence and is not clearly erroneous.'" *Id.* (quoting Home Co. v. Comm'r, 212 F.2d 637, 639 (10th Cir. 1954)). Not surprisingly, the Court of Appeals affirmed the Tax Court. *See id.* at 660.

In *Scheidelman v. Commissioner*, 755 F.3d 148 (2d Cir. 2014), the Court of Appeals for the Second Circuit stated, "[f]or the purpose of this appeal we will assume without deciding that *Scheidelman* was entitled to § 7491's burden shift. However, we conclude that § 7491 is immaterial to the outcome on this record because, as set forth above, substantial evidence supports the conclusion of the Tax Court that the Commissioner's 'position is the more persuasive, regardless of the burden of proof.'" *Id.* at 154.

In *Estate of Elkins v. Commissioner*, 767 F.3d 443 (5th Cir. 2014), the Court of Appeals for the Fifth Circuit held that the Tax Court failed to shift the burden to the IRS, but it made "no difference in the end." *Id.* at 450. Philip Jones has argued that the *Elkins* case is inconsistent with other federal appellate decisions regarding the shifting of the burden of proof under Code Section 7491. *See* Philip N. Jones, *Burden of Proof—The Fifth Circuit Muddies the Waters*, 122 J. TAX'N 36 (2015).

The burden of proof proved to be important, at least in terms of litigation strategy, in *Longino v. Commissioner*, 593 F. App'x 965 (11th Cir. 2014), when the Court of Appeals for the Eleventh Circuit held that the burden remained with the taxpayer. The taxpayer, believing the burden had shifted, failed to present evidence on a number of claimed deductions, and thus, the court affirmed the Tax Court's determination that the taxpayer had not substantiated the deductions. *Id.* at 971.

§ 11.05 (SETTLEMENT OF LITIGATED TAX CASES)

In *Shah v. Commissioner*, 2015 U.S. App. LEXIS 10679 (7th Cir. 2015) (per curiam), the Court of Appeals for the Seventh Circuit reversed the Tax Court's acceptance of a settlement agreement because the taxpayers continued to dispute the IRS's deficiency calculations at the time the purported settlement agreement was entered into. The background of the case is as follows: a month after the parties submitted a Stipulation of Settled Issues to the Tax Court, the IRS filed a motion for entry of decision, stating that it had mailed the taxpayers a letter containing decision documents and its deficiency calculation. *Id.* at *3. The taxpayers did not respond to the letter or phone calls regarding the decision documents. *Id.* at *4. The IRS requested that the Tax Court enter a decision based on the explanatory letter that stated "'to finalize the settlement,' the parties still had to to 'file with the Tax Court a decision document reflecting that settlement agreement.'" *Id.* The taxpayers filed an objection to the IRS's motion because the parties had not jointly arrived at the deficiency amounts stated in the explanatory letter. *Id.* After the Tax Court deferred the motion to allow time for the parties to reach agreement, the IRS prepared new deficiency calculations, which it attempted to get the taxpayers to agree to. *Id.* at 6. The taxpayers submitted a status report explaining that Mr. Shah was ill and "could no longer 'understand mathematical calculations'" and that Mrs. Shah "'did not understand the case because she was never involved in tax return preparation.'" *Id.* at *6. The Tax Court granted the IRS's motion without giving the parties more time to reach agreement. *Id.* at *7. The Seventh Circuit reversed and remanded the case back to the Tax Court, because the taxpayers "plainly disagreed with the deficiency amounts submitted by the Commissioner," and the IRS had not in fact argued that a settlement was in place until after its motion had been granted. *Id.* at *9.

§ 11.06 (AWARDS OF ADMINISTRATIVE AND LITIGATION COSTS AND FEES TO TAXPAYERS)

In late 2009, the Treasury Department issued proposed regulations relating to awards of administrative costs and attorneys fees under section 7430. Regulations Under I.R.C. Section 7430 Relating to Awards of Administrative Costs and Attorney's Fees, 74 Fed. Reg. 61589 (Nov. 25, 2009). For the most part, the revisions merely conform the regulations to Congressional amendments made to section 7430 in 1997 and 1998. Except as otherwise noted below, the assignments to the section 7430 regulations and the citations to those regulations within the text remain current.

§ 11.06[A] (Qualification Requirements)

In the fourth line of the first paragraph on page 433, replace the reference to Treas. Reg. § 301.7430-5(d) with Prop. Reg. § 301.7430-5(e).

In the last line of the second paragraph on page 433, replace the reference to Treas. Reg. § 301.7430-5(e) with Prop. Reg. § 301.7430-5(f)(1).

Replace the first two sentences of the fourth paragraph on page 433 with the following:

> In administrative proceedings before the IRS, the position that the government must substantially justify is determined as of the earliest of (1) the date the taxpayer receives the decision of the Appeals Division; (2) the date the IRS issues the notice of deficiency; or (3) the date the IRS issues the first notice of proposed deficiency (30-day letter) that allows the taxpayer the opportunity to seek Appeals consideration. Prop. Reg. § 301.7430-3(c)(1), (4).

In the last line of the carryover paragraph on the top of page 434, replace the reference to Treas. Reg. § 301.7430-5(c) with Prop. Reg. § 301.7430-5(d)(7).

The Fifth Circuit in Hennessey v. Commissioner, 2008-2 U.S.T.C. (CCH) ¶ 50,623 (5th Cir. 2008), affirmed the Tax Court's denial of administrative and litigation costs to a couple who settled a tax deficiency with the IRS on a docketed basis. As part of the settlement, the IRS denied a portion of the couple's business expense deductions. After the settlement was agreed upon by the parties, the couple filed a motion in Tax Court seeking a recovery of expenses under section 7430. The Tax Court denied the couple's request, finding that the IRS's position was substantially justified. The Fifth Circuit affirmed:

> The Hennesseys failed to carry their burden of proving their deductions were proper. They did not provide the IRS with supporting documentation for all of their trips; some of the documentation they did provide was not consistent with their deductions; and they did not provide the required business purpose needed for several deductions. Those errors provided the IRS with the substantial justification it needed to take its administrative position.

Id.

In *Reynoso v. United States*, 2011 U.S. Dist. LEXIS 87929 (N.D. Cal. 2011), the District Court awarded the taxpayer administrative and litigation costs in a refund case in which the taxpayer recovered over 80 percent of the alleged overpayment. The court found that the IRS's failure to return a cash bond after repeated requests by the taxpayer represented a position that was not "substantially justified." *Id.* at *21. The court rejected the IRS's argument that, because the IRS had never sent the taxpayer a notice of disallowance or notice of deficiency in response to the taxpayer's refund claim, the IRS had not taken a position with respect to the administrative proceedings. *Id.* at *11, *16. Section 7430(c)(7) provides that, with respect to administrative proceedings, the "position of the United States, is the position taken "as of the earlier of: (i) the date of the receipt by the taxpayer of the notice of decision of the Office of Appeals, or (ii) the date of the notice of deficiency." *Id.* at *11–12. Without parsing through the statutory language, the court concluded that:

> The IRS's failure to respond to Plaintiff's repeated requests for his refund and for the return of the unapplied portion of the cash bond was tantamount to a denial of those requests. The government cannot insulate itself from paying attorney's fees by simply ignoring a refund request instead of issuing a formal denial. The Court thus rejects the government's contention that it did not take a "position" prior to litigation in this case. Plaintiff is therefore entitled to costs and fees incurred at the administrative level.

Id. at *16.

§ 11.06[B] (Measure of Recovery)

The proposed regulations issued in 2009 clarify when special factors exist that would justify an award of costs in excess of the statutory cap.

> (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 the [ ] 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 [ ] 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 [ ] 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 [ ] 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 [ ] 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 [ ] 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 qualified 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 [ ] 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.

Prop. Reg. § 301.7430-4(b)(3).

A recent Tax Court decision illustrates the need to timely file relevant motions in order to recover costs and fees under section 7430. The taxpayers in *Foote v. Commissioner*, T.C. Memo. 2013-276, 2013 Tax Ct. Memo LEXIS 288 (Dec. 9, 2013), were successful in reducing their deficiency and penalty assertions from $124 million to $375,000, but they failed to raise a claim for administrative and litigation costs in the prior Tax Court proceedings before the decision of the Tax Court became final. Although the taxpayers sent a letter to the IRS requesting a recovery of costs and fees shortly after the Tax Court decision was entered, they failed to submit a motion to the Tax Court in compliance with Tax Court Rule 231. Consistent with its prior holding in *Gustafson v. Commissioner*, 97 T.C. 85 (1991), the Tax Court ruled that because the taxpayers could have pursued their recovery for costs during the prior deficiency proceeding but failed to do so, the doctrine of res judicata barred them from litigating in the issue in a later case. *Id*.

§ 11.07[A] (Collateral Estoppel and Res Judicata)

In *Batchelor-Robjohns v. United States*, No. 14-10742, 2015 U.S. App. LEXIS 9366, (11th Cir. June 5, 2015), the Court of Appeals for the Eleventh Circuit held that res judicata did not preclude the government's tax claim. That case was a refund suit brought by the estate of Mr. Batchelor. *Id.* Mr. Batchelor, prior to his death, had been the sole shareholder in a corporation that had been placed in involuntary bankruptcy. *Id.* at *3. The IRS sought to collect the corporation's unpaid taxes from Mr. Batchelor on a transferee liability theory. He won that case on summary judgment after the court struck the testimony of the government's valuation experts for failure to comply with the federal rules of civil procedure. *Id.* In *Batchelor-Robjohns*, the estate argued that the earlier decision barred litigation of the valuation question. *Id.* at *12. The Eleventh Circuit disagreed. *Id.* at *14–15. It held that the two suits involved different causes of action because they involved different tax liabilities: corporate tax liabilities in the bankruptcy suit and individual tax liabilities in the Eleventh Circuit case. *Id.*

§ 11.07[B] (Coordination of Deficiency and Refund Suits)

In *Cheesecake Factory, Inc. v. United States*, 111 Fed. Cl. 686, 694–95 (2013), the Court of Federal Claims held that because the taxpayer had filed a Tax Court petition after receiving a notice of deficiency for the 2005 tax year, the Court of Federal Claims lacked jurisdiction over the case. *Id.* at 688. The suit was over penalties and interest for the taxpayer's 2005 tax year that the taxpayer alleged it overpaid because the IRS did not appropriately credit overpayments from prior years to its 2005 tax year. *Id.*

In *Cheesecake Factory*, after the taxpayer petitioned the Tax Court in 2009, the court entered its decision in 2010, based on a settlement. *Id.* at 690. After that, the taxpayer filed a refund suit in District Court that included a claim with respect to penalties and interest for the 2005 tax year. *Id.* The parties settled that suit, too, but without addressing that claim. Id. "[T]he IRS informed plaintiff that, although the IRS believed that plaintiff's '2005 claim was properly denied, in full,' plaintiff could 'still pursue this 2005 year claim in District Court by timely re-filing [its] suit.'" *Id.* (quoting Compl. Ex. D (Order on Stipulation for Dismissal Without Prejudice to Refile until July 2, 2012, Cheesecake Factory, Inc. v. United States, No. 2:10-cv-08157 R (FFMx) (C.D. Cal. Dec. 16, 2011)).

In holding that it lacked jurisdiction over the case, the Court of Federal Claims observed that Code section 6512 states that after a taxpayer files a petition in Tax Court, "'no credit or refund of income tax for the same taxable year . . . in respect of which the Secretary has determined the deficiency shall be allowed or made and no suit by the taxpayer for the recovery of any part of the tax shall be instituted in any court,' except in certain limited circumstances." *Id.* at 691 (quoting IRC § 6512(a)). The court further stated that "[t]he bar in I.R.C. § 6512(a) is applicable even if 'circumstances prevented the taxpayer from raising an issue during the earlier Tax Court proceeding.'" *Id.* (quoting Solitron Devices, Inc. v. United States, 16 Cl. Ct. 561, 567

(1989)).

The taxpayer made a creative argument for the application of Code section 7422(e)—referring to the penalties and interest at issue as "zombies"—but the court rejected it because the taxpayer had not already filed in refund court when it received the notice of deficiency:

> Plaintiff responds that "[t]he Court of Claims does not lose jurisdiction over claims before it for years in which there is a parallel proceeding in the Tax Court, unless the Tax Court matter relates to an 'income tax [for which the Government mails] a notice that a deficiency has been determined in respect of the tax which is the subject matter of the taxpayer's suit [in the Court of Claims.]'" Pl.'s Resp. 1 (alterations in original) (quoting I.R.C. § 7422(e)). According to plaintiff, because the notice of deficiency in this case (which was issued in 2009 after plaintiff's audit by the IRS with respect to plaintiff's 2005 tax year) "had nothing to do with either of the interest and penalty assessments in 2006 and 2007," those assessments amounted to "zombie penalties and interest" as to which "no tax 'deficiency' was involved." *Id.* at 8–9.
>
> However, section 7422(e) of the Internal Revenue Code, cited by plaintiff in support of its argument in favor of the court's jurisdiction, . . . is not relevant to this case because it pertains to cases filed prior to the issuance of a notice of deficiency. Specifically, section 7422(e) provides that, if a notice of deficiency is mailed "prior to the hearing of a suit brought by a taxpayer in a district court or the . . . Court of Federal Claims for the recovery of any income tax . . . (or any penalties relating to such taxes) . . . , the proceedings in [the] taxpayer's suit shall be stayed" until the expiration of "the period of time in which the taxpayer may file a petition with the Tax Court for a redetermination of the asserted deficiency." I.R.C. § 7422(e). If the taxpayer then files a petition with the Tax Court in response to the notice of deficiency, the district court or the Court of Federal Claims (depending on where the original suit was brought) "shall lose jurisdiction of [the] suit to whatever extent jurisdiction is acquired by the Tax Court." *Id.*
>
> Here, when the notice of deficiency was issued on July 2, 2009, plaintiff had not yet filed this suit, nor was any suit pending in this court or any district court at the time that plaintiff filed its petition in the Tax Court on October 5, 2009. *See supra* Part I. Accordingly, plaintiff's reliance on section 7422(e) is misplaced. Nevertheless, the court notes that, even if section 7422(e) applied, the Tax Court's jurisdiction under section 7422(e) would still include the entire subject of the correct tax for the particular year.

Id. at 692 (citation omitted).

§ 11.08 (IRS Use of Summons in Discovery)

In *United States v. Clarke*, 134 S. Ct. 2361, 2367 (2014), the U.S. Supreme Court held that a taxpayer challenging the validity of a summons in an enforcement proceeding is "entitled to examine an IRS agent when he can point to specific facts or circumstances plausibly raising an inference of bad faith." In part, the four individuals who received summonses (the respondents) argued that the IRS was retaliating for the respondents' refusal to agree to an extension of the statute of limitations on assessment. *Id.* at 2366. The Court remanded the case to the Eleventh Circuit "to determine whether Appellants . . . have pointed to specific facts or circumstances plausibly raising an inference that the Internal Revenue Service (the IRS or the Service) issued five administrative summonses in bad faith such that Appellants were entitled to examine an IRS agent regarding the Service's reasons for issuing the summonses." United States v. Clarke, 573 Fed. Appx. 826, 2014 U.S. App. LEXIS 14190 |(11th Cir. 2014).

The Court of Appeals remanded the case to the District Court for the Southern District of Florida, which ruled in favor of the government. United States v. Clarke, 2015 U.S. Dist. LEXIS 33312 (S.D. Fla. 2015). Part of the respondents' argument in district court was that "'[e]vidence from the IRS is likely to show that they had an internal policy requiring that they always maintain a two year statute of limitations cushion, and, when they could not arrange for that, it was their practice to finalize an FPAA and then serve dragnet IRS summonses asking for things they knew they did not need for no apparent reason.'" *Id.* at *7 (quoting the taxpayer's brief). The court rejected that argument, calling it a "naked allegation," and ultimately found that the respondents "submissions do not show facts giving rise to a plausible inference of improper motive regarding issuance of the summons." *Id.* The *Clarke* opinions are discussed in further detail in Chapter 4 of this Supplement.

§ 11.09 (LITIGATION SANCTIONS)

The Court declined to impose sanctions under Code section 6673 on a taxpayer who cooperated in the IRS stipulation process prior to trial, even though the taxpayer had "not fully abandoned arguments that we typically describe as frivolous" and had previously made frivolous arguments in other proceedings before the Tax Court. Buckardt v. Commissioner, T.C. Memo. 2012-170, 2012 Tax Ct. Memo LEXIS 170 *19. The court noted that it was the taxpayer's first collection due process review proceeding. *Id.*

By contrast, in *Leyshon v. Commissioner*, T.C. Memo. 2015-104, 2015 Tax Ct. Memo LEXIS 113, the Tax Court imposed a $2,000 penalty under Code section 6673 because the taxpayer maintained frivolous positions and assisted his wife in maintaining frivolous positions in other Tax Court cases. The taxpayer argued in part that "wages do not 'constitute taxable income,'" which the court found to be frivolous. *Id.* at *8–9. Because the court had given the taxpayer repeated warnings about the frivolous nature of his arguments and he had assisted his wife in making similar arguments, the court imposed the penalty and warned the taxpayer of the possibility of higher sanctions in the future. *Id.* at *32–33.

§ 12.02[A][1] (The Failure to File Penalty)

The Heroes Earnings Assistance and Relief Tax Act of 2008, Pub. L. No. 110-245, increased the minimum penalty for failure to file a return to the lesser of $135 (rather than $100) or 100 percent of the amount required to be shown as tax on the return. I.R.C. § 6651(a). The Tax Increase Prevention Act of 2014, Pub. L. No. 113-295, adjusts the amount of the $135 minimum penalty for inflation. The inflation adjustment is effective for returns filed after December 31, 2014.

As noted in the text, a tax return that shows no net tax due will not be subject to a failure to file penalty, not even the minimum penalty, notwithstanding the fact that the taxpayer files the return after the specified due date. *See* I.R.C. §§ 6651(a) (providing that the minimum penalty "shall not be less than *the lesser of* $135 or 100 percent of the amount required to be shown as tax on such return) (emphasis added), 6651(b)(1) (providing that for purposes of the failure to file penalty "the amount of tax required to be shown on the return shall be reduced by the amount of any part of the tax which is paid on or before the date prescribed for payment"). If the return shows a net tax due but the taxpayer requests an extension of time to file and files the return within the extension period, the failure to file penalty is also zero. I.R.C. § 6651(a)(1) (providing that the date prescribed for filing the return is "(determined with regard to any extension of time for filing))."

What if the taxpayer submits a timely extension of time to file a return that reflects a net tax due, the taxpayer pays the tax during the extension period, but does not file the return until after the extension period has expired: Does the failure to file penalty apply? While section 6651(b) indicates that the penalty base is reduced by amounts paid on or before the date prescribed for payment, that Code section must be read in combination with section 6151(c). Code section 6651(c) states: "In any case in which a tax is required to be paid on or before a certain date, any reference in this title to the date fixed for payment of such tax shall be deemed a reference to the last day fixed for such payment (determined *without* regard to any extension of time for paying the tax)" (emphasis added). Assume, for example, that a taxpayer timely files a request for a six-month extension of time to file a return that reflects a $10,000 amount due. Five months later, in an effort to reduce interest accruals, the taxpayer submits a payment of $11,000. The taxpayer files the return eight months after the extension of time to file has expired. In this case, although the taxpayer overpaid the tax liability within the extension of time to file, the taxpayer had not paid any tax by the original unextended due date. The penalty would be $2,500, reflecting a maximum 25% penalty given that the return was filed more than five months after the extended due date. *See* Liftin v. United States, 754 F.3d 975 (5th Cir. 2014), Philip N. Jones, *Federal Circuit Imposes Penalty on No-Tax-Due Return*, 121 J. TAX'N 171 (Oct. 2014) (noting that "illogical as it might be, the failure-to-file penalty is based on the amount of tax paid as of the original unextended due date, and a snapshot taken as of that date disregards taxes paid just one day later, or six weeks later, or two and a half years later.").

In April of 2014, the IRS issued updated guidance on an existing but rarely used policy that allows taxpayers to request abatement of the failure to file and failure to pay penalties assessed against the taxpayer for the first time. *See* IRS Memorandum (SBSE-20-0414-0623) on First-Time Penalty Abatement (amending IRM 20.1.1.3.6.1), *available at* DAILY TAX REP. (BNA), Apr. 14, 2014, at G-4. To qualify, the taxpayer must meet three requirements: (1) establish filing compliance, which requires the taxpayer to have filed, or filed a valid extension for, all currently required returns; (2) establish payment compliance, which requires the taxpayer to have paid, or arranged to pay, any outstanding tax liability; and (3) establish that the taxpayer has not been assessed penalties during the three years prior to the tax return in question. IRM 20.1.1.3.6.1.1(a), (b). For further details about the first-time penalty abatement program see Jim Buttonow, *Using the First-Time Penalty Abatement Waiver*, 44 TAX ADVISER 450 (2013); Katherine R. Dodson, *Have Mercy on Me: IRS Penalty Abatements* via *Modified First Time Penalty Abatement and Establishing Reasonable Cause Defenses*, J. TAX PRAC. & PROC., Apr.-May 2014, at 43.

§ 12.02[A][2] (The Reasonable Cause Defense)

The IRS has revised and renumbered some of the excerpts from Part 20 of the Internal Revenue Manual that are included in the text. The revisions are minor and do not affect the overall content of the excerpts.

A Ninth Circuit opinion probes the distinction drawn in *Boyle*, excerpted in the text, between substantive and non-substantive tax advice. The Court of Appeals ruled in *Knappe v. United States*, 713 F.3d 1164, *cert. denied*, 134 S. Ct. 422 (2013), that an executor failed to exercise ordinary business care and prudence in relying on his accountant's incorrect advice about the deadline for filing an estate tax return. As a result, the court upheld the IRS's failure to file penalty assertion and rejected the executor's reasonable cause defense. *Id.* at 1165, 1175. The Ninth Circuit stated:

> Cases addressing reasonable cause for late filing of tax returns fall into two general categories. In the first category are cases involving taxpayers who delegate the task of filing a return to an expert agent, only to have the agent file the return late or not at all. The leading case in this category is *Boyle*, 469 U.S. 241 . . . . * * *
>
> The Supreme Court held that Boyle's reliance on his attorney to file the tax return timely was not reasonable cause for the delay. "Congress has placed the burden of prompt filing on the executor," the Court explained, "not on some agent or employee of the executor." *Id*. at 249. The Court described the taxpayer's "fixed and clear" duty as "an obligation to ascertain the statutory deadline and then to meet that deadline, except in a very narrow range of situations." *Id*. at 249-50. Delegating the duty of filing to an agent was not within the "very narrow range of situations" in which failing to meet a statutory filing deadline would be

excused, because "Congress has charged the executor with an unambiguous, precisely defined duty to file the return within nine months." *Id*. at 250. That the executor's agent "was expected to attend to the matter does not relieve the principal of his duty to comply with the statute." * * *

In the second category are cases in which a taxpayer relies on an agent's erroneous advice that no return is due. Courts have consistently held that such reliance *does* constitute reasonable cause for delay. Even the *Boyle* court appeared expressly to endorse such a rule:

> When an accountant or attorney *advises* a taxpayer on a matter of tax law, such as whether a liability exists, it is reasonable for the taxpayer to rely on that advice. Most taxpayers are not competent to discern error in the substantive advice of an accountant or attorney. To require the taxpayer to challenge the attorney, to seek a "second opinion," or to try to monitor counsel on the provisions of the Code himself would nullify the very purpose of seeking the advice of a presumed expert in the first place. "Ordinary business care and prudence" do not demand such actions.

469 U.S. at 250–51 (citations omitted). Cases in this category stand for the principle that the question of whether a return is due is a matter of substantive tax law, and that a taxpayer acts with ordinary business care and prudence when he relies on an expert's answer to that question. *See, e.g., United States v. Kroll*, 547 F.2d 393, 396 (7th Cir. 1977) (holding that "when there is no question that a return must be filed, the taxpayer has a personal, nondelegable duty to file the tax return when due" but noting that "[w]hether or not the taxpayer is liable for taxes is a question of tax law which often only an expert can answer. The taxpayer not only can, but must, rely on the advice of either an accountant or a lawyer. This reliance is clearly an exercise of ordinary business care and prudence.").

This case does not fall squarely into either category. Knappe neither delegated the task of filing the return to a neglectful agent nor received mistaken advice that no taxes were due. Rather, he personally filed the return after the actual deadline, but within the time that Burns erroneously had assured him was available.

In *Boyle*, the Supreme Court expressly declined to reach the question posed by this case:

> Courts have differed over whether a taxpayer demonstrates "reasonable cause" when, in reliance on the advice of his

> accountant or attorney, the taxpayer files a return after the actual due date but within the time the adviser erroneously told him was available. We need not and do not address ourselves to this issue.

469 U.S. at 251 n.9 (citations omitted). Our sister circuits have reached contradictory conclusions. *Compare, e.g., Estate of Kerber v. United States*, 717 F.2d 454, 455–56 (8th Cir. 1983) (per curiam) (refusing to find reasonable cause where an executrix's attorney "correctly advised her that it would be necessary to file an estate tax return" but "erroneously believed that the return was due one year," rather than nine months, "after the decedent's death"), *with Estate of Bradley v. Comm'r*, T.C. Memo 1974-17, 33 T.C.M. (CCH) 70, 72–73 (1974) (holding that it was "consistent with ordinary business care and prudence for [the executor] to consult a member of an accounting firm which regularly prepared tax returns for advice on the due date of the estate tax return and to rely on the advice he received"), *aff'd*, 511 F.2d 527 (6th Cir. 1975).

This case is more like the first category than the second because of the Supreme Court's distinction between substantive and nonsubstantive tax advice, *Boyle*, 469 U.S. at 251–52, which we recently recognized in *Baccei v. United States*, 632 F.3d 1140, 1148–49 (9th Cir. 2011). Reading those cases closely, we conclude that the question of when the estate-tax return was due once an extension had been obtained was a nonsubstantive one. For that reason, Knappe did not exercise ordinary business care and prudence when he relied unquestioningly on Burns's advice about the extended deadline, and he unreasonably abdicated his duty to ascertain the filing deadline and comply with it.

Id. at 1169–71. *Compare* Estate of Thouron v. United States,752 F.3d 311 (3rd Cir. 2014) (finding that *Boyle* does not preclude a taxpayer from establishing reasonable cause for failing to timely pay estate tax liability when taxpayer's attorney advised, erroneously, that the estate may qualify to pay the liability in installments, and remanding the case to determine whether taxpayer's reliance on such advice was reasonable).

§ 12.02[C] (Accuracy-Related Penalties—Code Section 6662)

According to IRS data, accuracy-related penalties assessed by the IRS have increased significantly over the past several years. The number of accuracy-related penalties assessed against individuals rose from 58,366 in 2005 to 554,467 in 2014. This represents an almost 900 percent increase. Penalties assessed against businesses nearly quadrupled in that same time period, increasing from 1,342 in 2005 to 5,009 in 2014. *Compare* 2005 IRS Data Book, Table 27, *available at* http://www.irs.gov/pub/irs-soi/05databk.pdf *with* 2014 IRS Data Book, Table 17, *available at* http://www.irs.gov/uac/SOI-Tax-Stats-Civil-Penalties-Assessed-and-Abated-by-Type-of-Tax-and-Type-of-Penalty-IRS-Tax-Stats-Table-17.

The IRS recently released guidance for applying the economic substance doctrine codified in Code section 7701(o). The guidance also affects the economic substance prong of the accuracy-related penalty contained in section 6662(b)(6). *See* Notice 2014-58, 2014-44 I.R.B., *available at* http://www.irs.gov/irb/2014-44_IRB/ar07.html.

A recent Tax Court decision, *Rand v. Commissioner*, 141 T.C. 376 (2013), raises the question of how to calculate the base for the accuracy-related penalty—the "portion of an underpayment of tax required to be shown" on the return. Section 6664(a) defines an "underpayment" as the amount by which the tax imposed exceeds "the amount shown as the tax by the taxpayer on his return." The question is *Rand* was how to calculate the amount of tax shown on the return when the taxpayer had refundable credits that the IRS had disallowed. *Rand*, 141 T.C. at 377. Stated differently, can a taxpayer "underpay" her tax liability by claiming refundable credits to which she was not entitled?

The taxpayers in *Rand* reported on their jointly filed 2008 tax return $0 of taxable income and $144 of self-employment tax liability. The taxpayers also reported a total of $7,471 of refundable credits, made up primarily of the earned income tax credit, and claimed a $7,327 refund. The IRS determined that the taxpayers were not entitled to any of the refundable credits and asserted a $7,327 deficiency. *Id*. at 378–79. The IRS also imposed a 20 percent accuracy-related penalty, calculating the penalty by taking into account the disallowed refundable credits when determining the amount of tax shown on the return, which, according to the IRS, was negative $7,327. *Id*. at 380–81. The taxpayers argued, essentially, that the amount of tax shown on the return should be computed without regard to the credits. Under the taxpayer's calculation, the tax shown on the return was $144, which was the same as the tax imposed, resulting in no underpayment. *Id*. at 381–82.

The Tax Court majority rejected both arguments, ruling instead that the tax shown on the return is reduced by disallowed refundable credits, but that the tax shown may not be negative. The majority came to this conclusion based upon principles of statutory construction and by drawing inferences from Code section 6621, which uses the same phraseology when defining a deficiency. According to the majority:

> Whether we review the context surrounding the definition of an underpayment under section 6664 or the definition of a deficiency under section 6211, the statute is silent as to the treatment of the refundable tax credits at issue here. In the absence of anything showing a contrary congressional intent, the canon *expressio unius est exclusio alterius* applies. Because Congress expressly chose to disregard certain credits when determining the amount shown as the tax by the taxpayer on his return when calculating a deficiency, it follows that other credits should be taken into account to reduce the amount so shown. Because the phrase "the amount shown as the tax by the taxpayer" appears in both sections, 6211 and 6664, we likewise conclude that the amount shown as the tax by the taxpayer on

> his return when calculating an underpayment should be reduced by refundable credits.

Id. at 388.

On the question of whether the refundable credits can produce a negative tax shown for purposes of section 6664(a), the majority found a distinction between the definitions in section 6664 and 6621.

> Based on the negative tax provision of section 6211(b)(4), we conclude that these credits do not yield a negative tax for purposes of defining an underpayment under section 6664(a)(1)(A). We return to our premise that, because section 6664(a)(1)(A) uses the same phrase "the amount shown as the tax by the taxpayer" as section 6211(a), we should interpret it consistently with section 6211. And we have concluded that, but for section 6211(b)(4), the specified refundable credits would not yield a negative tax for the amount shown as the tax by the taxpayer. Thus, we must likewise conclude that these refundable credits would not yield a negative tax for the amount shown as the tax under section 6664 unless there is a counterpart to section 6211(b)(4). In turning to section 6664, we find no counterpart to section 6211(b)(4). Accordingly, excess earned income credits, additional child tax credits, and recovery rebate credits do not result in a negative tax for the amount shown as the tax by the taxpayer on his return.

Id. at 390–-91. In light of the majority's interpretation, the taxpayers' underpayment was $144 ($144 of tax liability minus $0 tax shown on the return = $144), resulting in a penalty of $29 ($144 multiplied by 20 percent).

A dissenting opinion by Judge Gustafson (joined by Judges Halpern and Goeke) concluded that the amount shown on the return was $144, resulting in no underpayment and therefore no penalty. Judge Gustafson interpreted "the amount shown as the tax by the taxpayer on his return" as referring to the amount reported on line 61 of Form 1040, which is not reduced by refundable credits. *See id.* at 396–405 (Gustafson, J., dissenting).

A separate dissent by Judge Morrison (joined by Judge Colvin) agreed with the IRS's assertion that the tax shown on the return for purposes of section 6664 could be negative. Under this interpretation, the accuracy related penalty would be $1,494: 20 percent multiplied by $7,471 [excess of tax imposed ($144) minus the tax shown (-$7,327)]. In addition to relying on principles of statutory construction to reach the result, Judge Morrison's dissent also cites policy considerations:

> The purpose of the section 6662 penalty is to deter taxpayers from taking questionable tax return positions that they hope that the IRS will not discover. . . . Credits are reported by taxpayers on income tax returns, just as items of gross income and deductions are reported on income tax returns. . . . Taxpayers like

> Rand and [his wife], who make false claims of credits on their tax returns, hope that the IRS will not discover that they are not entitled to the credits. In the case of refundable credits, the claimants hope that the IRS will write them a refund check (as the IRS did for Rand . . .). False claims of credits on returns are as difficult for the IRS to detect as falsely reported items of gross income or deductions. Treating a false claim of credits as part of the "tax shown" on the return, and treating a false claim to refundable credits as potentially a report of negative tax, are consistent with the purpose of section 6662.

Id. at 407–08 (Morrison, J., dissenting).

§ 12.02[C][1] (Negligence or Disregard of Rules or Regulations)

A widely publicized case illustrates the limits on when a taxpayer can rely on a third-party opinion letter for penalty protection. In *Canal Corporation v. Commissioner*, 135 T.C. 199 (2010), the Tax Court imposed a substantial understatement penalty in excess of $36 million on a corporate taxpayer that had engaged in a joint venture transaction that was found to be a disguised sale. Tax Court Judge Kroupa rejected the taxpayer's section 6664(c) reasonable cause defense despite the fact that the taxpayer had received a favorable opinion from PricewaterhouseCoopers (PWC). For the reasons set forth below, she found that the opinion was based on unreasonable assumptions and that Canal Corporation (referred to as "Chesapeake" in the opinion) did not rely on the opinion in good faith:

> We now focus on whether PWCs advice was reasonable. Chesapeake contends that it relied on legal analysis prescribed in PWCs "should" opinion. Chesapeake submitted a draft, not the original, of the "should" opinion into evidence. We therefore look to the draft opinion to determine whether PWC's advice was reasonable.
>
> Chesapeake paid PWC an $800,000 flat fee for the opinion, not based on time devoted to preparing the opinion. Mr. Miller [the drafter, Eds.] testified that he and his team spent hours on the opinion. We find this testimony inconsistent with the opinion that was admitted into evidence. The Court questions how much time could have been devoted to the draft opinion because it is littered with typographical errors, disorganized and incomplete. Moreover, Mr. Miller failed to recognize several parts of the opinion. The Court doubts that any firm would have had such a cavalier approach if the firm was being compensated solely for time devoted to rendering the opinion.
>
> In addition, the opinion was riddled with questionable conclusions and unreasonable assumptions. . . . He [ ] relied on an irrelevant revenue procedure as the basis for issuing the "should" opinion. A "should" opinion is the highest level of comfort PWC offers to a client regarding whether the position taken by the

client will succeed on the merits.[n.15] We find it unreasonable that anyone, let alone an attorney, would issue the highest level opinion a firm offers on such dubious legal reasoning.

We are also nonplused by Mr. Miller's failure to give an understandable response when asked at trial how PWC could issue a "should" opinion if no authority on point existed. He demurred that it was what Chesapeake requested. The only explanation that makes sense to the Court is that no lesser level of comfort would have commanded the $800,000 fixed fee that Chesapeake paid for the opinion.

We are also troubled by the number of times the draft opinion uses "it appears." For example, it states, "[i]n focusing on the language of the 752 regs, it appears that such regulation adopts an all or nothing approach." Mr. Miller had no basis for that position other than his interpretation of the regulations. . . . PWC assumed away the very crux of whether the transaction would qualify as a nontaxable contribution of assets to a partnership. . . .We find that Chesapeake's tax position did not warrant a "should" opinion because of the numerous assumptions and dubious legal conclusions in the haphazard draft opinion that has been admitted into the record. Further, we find it inherently unreasonable for Chesapeake to have relied on an analysis based on the specious legal assumptions.

* * *

Moreover, Chesapeake did not act with reasonable cause or in good faith as it relied on Mr. Miller's advice. Chesapeake argues that it had every reason to trust PWCs judgment because of its long-term relationship with the firm. PWC crossed over the line from trusted adviser for prior accounting purposes to advocate for a position with no authority that was based on an opinion with a high price tag— $800,000.

Any advice Chesapeake received was tainted by an inherent conflict of interest. We would be hard pressed to identify which of his hats Mr. Miller was wearing in rendering that tax opinion. There were too many. Mr. Miller not only

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[n.15] Mr. Miller testified that tax practitioners render different levels of opinion based on their comfort that the legal conclusions contained in the opinion are correct as a matter of law assuming the factual representations and assumptions set forth in the opinion are also correct. A "reasonable basis" opinion has a 33-percent chance of success on the merits. See sec. 1.6662-3(b)(3), Income Tax Regs. A "substantial authority" opinion has a 40-percent chance of success on the merits. See sec. 1.6662-4(d)(2), Income Tax Regs. A "more likely than not" opinion has a 51-percent chance of success on the merits. *See id.* Mr. Miller did not give an exact percentage regarding a "should" opinion, but he testified that it is materially higher than that of a "more likely than not" opinion.

> researched and drafted the tax opinion, but he also "audited" WISCO's and the LLC's assets to make the assumptions in the tax opinion. He made legal assumptions separate from the tax assumptions in the opinion. He reviewed State law to make sure the assumptions were valid regarding whether a partnership was formed. In addition, he was intricately involved in drafting the joint venture agreement, the operating agreement and the indemnity agreement. In essence, Mr. Miller issued an opinion on a transaction he helped plan without the normal give-and-take in negotiating terms with an outside party. We are aware of no terms or conditions that GP required before it would close the transaction. We are aware only of the condition that Chesapeake's board would not close unless it received the "should" opinion. Chesapeake acted unreasonably in relying on the advice of PWC given the inherent and obvious conflict of interest. . . .
>
> We also find suspect the exorbitant price tag associated with the sole condition of closing. Chesapeake essentially bought an insurance policy as to the taxability of the transaction. PWC received an $800,000 fixed fee for its tax opinion. PWC did not base its fee on an hourly rate plus expenses. The fee was payable and contingent on the closing of the joint venture transaction. PWC would receive payment only if it issued Chesapeake a "should" opinion on the joint venture transaction. PWC therefore had a large stake in making sure the closing occurred.
>
> Considering all the facts and circumstances, PWC's opinion looks more like a quid pro quo arrangement than a true tax advisory opinion. If we were to bless the closeness of the relationship, we would be providing carte blanche to promoters to provide a tax opinion as part and parcel of a promotion. Independence of advisers is sacrosanct to good faith reliance. We find that PWC lacked the independence necessary for Chesapeake to establish good faith reliance. We further find that Chesapeake did not act with reasonable cause or in good faith in relying on PWC's opinion. We sustain respondent's determination that Chesapeake is liable for the accuracy-related penalty under section 6662(b)(2) for 1999.

Id. at 219–22.

Because the events in *Canal* occurred prior to 2004, the prohibition in section 6664(d)(4)(B)(iii) against reliance on a "disqualified opinion" did not apply. Query whether this provision would have provided another basis upon which the court could have ignored the KPMG opinion letter. For a more recent case in which the court found the taxpayer liable for a negligence penalty even though the taxpayer sought advice from two law firms and a major accounting firm, see *Candyce Martin 1999 Irrevocable Trust v. United States*, 822 F. Supp.2d 968, 1014 (N.D. Cal. 2011) (finding that trustee, "a highly-sophisticated and very successful businessman who had wide-ranging experience in analyzing business and investment transactions, should have known that the transaction was 'too good to be true.'"), *aff'd in part and rev'd in part on other grounds*, 739 F.3d 1204 (9th Cir. 2014).

In another case involving the reasonable cause defense to a gross valuation misstatement penalty, *106 Ltd. v. Commissioner*, 136 T.C. 67 (2011), *aff'd*, 684 F.3d 84 (D.C. Cir. 2012), Tax Court Judge Holmes explored the issue of when an advisor's involvement in the transaction giving rise to the penalty creates a conflict of interest such that reliance on the advisor's opinion is unreasonable.

> The gross-valuation-misstatement penalty can be rebutted by a showing of reasonable cause and good faith, sec. 6664(c), and a taxpayer will often argue (as Palmlund [the partnership's tax matters partner, Eds.] does) that he had reasonable cause and showed good faith by relying on professional advice. The regulation somewhat unhelpfully states that reliance on professional advice is "reasonable cause and good faith if, under all the circumstances, such reliance was reasonable and the taxpayer acted in good faith." Sec. 1.6664-4(b)(1), Income Tax Regs. The caselaw more helpfully points to three factors to test whether a taxpayer properly relied on professional advice. Neonatology Associates, P.A. v. Commissioner, 115 T.C. 43, 99 (2000), *affd.* 299 F.3d 221 (3d Cir. 2002).
>
> - First, was the adviser a competent professional who had sufficient expertise to justify reliance?
> - Second, did the taxpayer provide necessary and accurate information to the adviser?
> - Third, did the taxpayer actually rely in good faith on the adviser's judgment?
>
> A. *Expertise of Professional Advisers*
>
> Both Garza [the attorney who wrote the opinion letter, Eds.] and Turner & Stone [the accountants, Eds.] were licensed and would have appeared competent to a layman at the time they prepared the return. They would have appeared competent especially to Palmlund, since Garza had been his personal attorney for 20 years, and Turner & Stone had prepared his returns for about 18 years, all without incident. The Commissioner doesn't dispute their expertise in his brief, and so we have no trouble finding these advisers to have at least an adequate level of expertise.
>
> B. *Provision of Necessary and Accurate Information*
>
> We also find that Palmlund provided both Garza and Turner & Stone with all the relevant financial data needed to assess the correct level of income tax.

Sec. 1.6664-4(c)(1)(i), Income Tax Regs. The Commissioner doesn't dispute this either.

C. Actual Reliance in Good Faith

It's the third point—the issue of Palmlund's actual good-faith reliance on Garza's, and Turner & Stone's, professional advice—that's in dispute. There are at least three factors to consider:

- Palmlund's business sophistication and experience,
- the sloppy opinion letter, and
- whether Garza and Turner & Stone were promoters.

Palmlund's business sophistication and experience tend to make it harder to believe he didn't know the transaction was improper. Even though he wasn't a tax expert and was accustomed to relying on professional advisers for tax preparation, it seems doubtful that he acted in good faith in light of his "experience, knowledge, and education." Sec. 1.6664-4(b)(1), Income Tax Regs.

The mistake-ridden opinion letter is problematic as well. The opinion didn't accurately describe the transaction in this case, and the actual transaction was different from the generic transaction described in the opinion in some key respects. We don't, however, always take a close look at opinion letters when penalties are at issue. *See, e.g.*, Estate of Goldman v. Commissioner, 112 T.C. 317, 324 (1999) (opinion letter mentioned, but not scrutinized), *affd. without published opinion sub nom.* Schutter v. Commissioner, 242 F.3d 390 (10th Cir. 2000). And the Supreme Court has touched on this issue as well:

> To require the taxpayer to challenge the attorney, to seek a "second opinion," or to try to monitor counsel on the provisions of the Code himself would nullify the very purpose of seeking the advice of a presumed expert in the first place. * * * "Ordinary business care and prudence" do not demand such actions.

United States v. Boyle, 469 U.S. 241, 251 . . . (1985). On the other hand, at least one district court found that an opinion letter wasn't good enough only after taking a hard look at it. Long Term Capital Holdings v. United States, 330 F. Supp. 2d 122, 205-12 (D. Conn. 2004) (opinion letter wasn't based on all pertinent facts and circumstances and therefore didn't protect against penalties), *affd.* 150 Fed. Appx. 40 (2d Cir. 2005).

One doesn't need to look very hard to find problems with Garza's opinion. Section 1.6664-4(c)(1)(ii), Income Tax Regs., warns taxpayers against relying on advice that itself unreasonably relies "on the representations, statements, findings, or agreements of the taxpayer." Garza's opinion letter, as we described in our findings of fact, is filled with what appear to be (but which were not in fact) Palmlund's representations. And many of these "representations" just weren't true. Garza shouldn't have relied on them, and it's hard to believe that someone as sophisticated as Palmlund wouldn't at least suspect something was amiss.

And Palmlund also can't rely on Garza or Turner & Stone if they were promoters of the transaction. The caselaw is clear on this point—promoters take the good-faith out of good-faith reliance. *See, e.g.*, Neonatology Associates, 115 T.C. at 98. But what exactly makes a tax adviser a promoter has been less than clear. A frequently cited promoter-reliance case explains that "advice must generally be from a competent and independent advisor unburdened with a conflict of interest and not from promoters of the investment." Mortensen v. Commissioner, 440 F.3d 375, 387 (6th Cir. 2006), *affg.* T.C. Memo. 2004-279. But this merely tells us what a promoter is not, not what a promoter is.

Tigers Eye Trading, LLC v. Commissioner, T.C. Memo. 2009-121 offers a more workable definition of promoter: "an adviser who participated in structuring the transaction or is otherwise related to, has an interest in, or profits from the transaction." But there's a catch: This definition wasn't relied on or applied to the facts of that case—it's dictum. In *Tigers Eye*, we held only that we had jurisdiction in a partnership-level proceeding to determine whether a tax adviser was a promoter. Since the case was only at the summary-judgment stage, we left for another day the question of whether the tax adviser there actually was a promoter. *Id*. Still, the definition of "promoter" in that opinion was carefully crafted after considering relevant precedent.

One might need to be careful in applying the definition to some kinds of transactions—a tax lawyer asked by a businessman for advice on how to sell the family business through a tax-favored stock redemption might be said to have "participated in structuring the transaction"—but when the transaction involved is the same tax shelter offered to numerous parties, the definition is workable. As we observed in Countryside Ltd. P'ship. v. Commissioner, 132 T.C. 347, 352-55 (2009), a tax adviser is not a "promoter" of a transaction when he

- has a long-term and continual relationship with his client;
- does not give unsolicited advice regarding the tax shelter;
- advises only within his field of expertise (and not because of his regular involvement in the transaction being scrutinized);
- follows his regular course of conduct in rendering his advice; and
- has no stake in the transaction besides what he bills at his regular hourly rate.

> We therefore adopt the Tigers Eye definition for cases like this one, and apply it to Garza and Turner & Stone.
>
> We find that both these advisers not only participated in structuring the transaction, but arranged the entire deal. Garza set up the LLCs, provided a copy of the opinion letter, and coordinated the deal from start to finish. And both Garza and Turner & Stone profited from selling the transaction to numerous clients. Garza charged a flat fee for implementing it and wouldn't have been compensated at all if Palmlund decided not to go through with it. He wasn't being paid to evaluate the deal or tweak a real business deal to increase its tax advantages; he was being paid to make it happen. And Turner & Stone charged $8,000 for preparing Palmlund's tax returns—$6,500 more than usual. The extra fees were not attributable to an extraordinarily complex return—Palmlund's returns were always complex due to his various business interests—but, we find, were the firm's cut for helping to make the deal happen. Because Palmlund's advisers structured the transaction and profited from its implementation, they are promoters. Palmlund therefore could not rely on their advice in good faith.
>
> Even if the promoter issue was not in the picture, Palmlund would still have failed to establish his good-faith reliance. Palmlund's conversation with Denson—his private banker—also negates a finding of such reliance. It doesn't show good faith to enter into a "tax strategy" with the intent to "lose money." We find Denson to be credible. And his testimony, combined with the sloppy opinion letter and Palmlund's unusual level of "experience, knowledge, and education", demonstrates Palmlund's lack of good-faith reliance. *See* sec. 1.6664-4(b)(1), Income Tax Regs.

136 T.C. at 77–81 (footnotes omitted).

Compare the result in *106 Ltd.* with *Rawls Trading, L.P v. Commissioner*, T.C. Memo. 2012-340, 2012 Tax Ct. Memo LEXIS 341, involving a taxpayer who invested in a similar type of structured transaction. In *Rawls*, the Tax Court determined that, while the taxpayer could not reasonably rely on an opinion letter from his lawyer, he satisfied the reasonable cause standard in section 6664 based upon reliance on his accountant's advice. *Id.* at *41–42. Unlike the taxpayer in *106 Ltd.*, the Tax Court found there was no evidence to suggest that Mr. Rawls' accountant had a financial stake in the transaction or that the accountant was unable to give objective, independent advice. *Id.* at *34. The court also found that the accountant did have sufficient expertise to justify reliance, Mr. Rawls provided all the relevant information to the accountant, and Mr. Rawls' reliance on his accountant's advice was in good faith. *Id.* at *35–41. For an analysis of the *Rawls* decision, see Richard M. Lipton, *Reasonable Cause and Good Faith Reliance on an Advisor Help a Son-of-Boss Taxpayer Avoid Penalties*, 118 J. TAX'N 249 (2013).

What sort of "advice" from a tax practitioner supports a reasonable cause defense to an accuracy-related penalty? The taxpayers in *Woodsum v. Commissioner*, 136 T.C. 585 (2011), realized a $3.4 million gain reported to them on Form 1099-MISC. The taxpayers hired Venture Tax Services (VTS), a firm including a lawyer and CPA, to prepare their return and provided the preparers with the 1099. The return, however, omitted the $3.4 million gain. The taxpayers conceded the deficiency resulting from the failure to report the income but contested the IRS's assertion of a substantial understatement penalty, claiming that they relied in good faith on the return preparer. The Tax Court rejected the argument:

> For purposes of section 6664(c), a taxpayer may be able to establish reasonable cause and good faith (and thereby avoid the accuracy-related penalty of section 6662) by showing his reliance on professional advice. 26 C.F.R. sec. 1.6664-4(b)(1). As we stated in *Neonatology Associates, P.A. v. Commissioner*, 115 T.C. 43, 99 (2000), *aff'd*. 299 F.3d 221 (3d Cir. 2002):
>
>> for a taxpayer to rely reasonably upon advice so as possibly to negate a section 6662(a) accuracy-related penalty determined by the Commissioner, the taxpayer must prove by a preponderance of the evidence that the taxpayer meets each requirement of the following three-prong test: (1) The adviser was a competent professional who had sufficient expertise to justify reliance, (2) the taxpayer provided necessary and accurate information to the adviser, and (3) the taxpayer actually relied in good faith on the adviser's judgment.
>>
>> * * *
>>
>> Seeking to meet these standards, petitioners assert (1) that VTS and its attorney and C.P.A. were competent and experienced professionals, (2) that petitioners provided VTS with the necessary and accurate information, i.e., the Form 1099-MISC reporting the $3.4 million, and (3) that petitioners relied on VTS to prepare the return and report the $3.4 million—all of which the parties have stipulated. . . .
>
> In order to constitute "advice" within the definition of the regulation, the communication must reflect the adviser's "analysis or conclusion". The taxpayer must show (in the words of *Neonatology Associates*, 115 T.C. at 99 (emphasis added)) that he "relied in good faith on the adviser's *judgment*." Petitioners present no testimony of the preparer (nor any other evidence) to show that the income was omitted from the return because of any "analysis or conclusion" or "judgment" by VTS that the income was not taxable. When the Supreme Court discussed the "reasonable cause" defense in *Boyle* [469 U.S. 241 (1985)], it

> characterized the relevant professional role as giving “substantive advice”, *id*. at 251, and contrasted that professional function with things that “require[] no special training”, *id.* at 252. No “special training” was required for Mr. Woodsum to know that the law required him to include on that return an item of income that he had received and that Deutsche Bank had reported on Form 1099. The including of that income on their tax return is what petitioners say they intended when they handed over their information returns to VTS.
>
> Petitioners make no suggestion that VTS gave them “substantive advice” to omit the $3.4 million or that petitioners relied on any such substantive advice. On the contrary, petitioners stipulated that they “relied upon Venture Tax Services to prepare their 2006 tax return *and include all of the items* relating to the over 160 information returns provided to Venture Tax Services on said return”. . . . There is no evidence that when VTS instead omitted the $3.4 million, it thereby was exercising “analysis” or “judgment” or was making a professional advice recommendation to petitioners; rather, it was failing, in that specific instance, to carry out petitioners’ general instruction. In signing the return thus erroneously prepared, petitioners were not deliberately following substantive professional advice; they were instead unwittingly (they contend) perpetuating a clerical mistake. The defense of reliance on professional advice has no application here.

Id. at 592–94.

For a helpful discussion of how tax practitioners can help clients establish reasonable cause as a penalty defense, see Nancy T. Bowen, *Ten Practical Tips to Establish Reasonable Cause for Removing Penalties*, DAILY TAX REP. (BNA), Nov. 9, 2011, at J-1; *see also* Dwaune Dupree & Ken Jones, *Reasonable Cause: Reliance on Tax Advisors*, J. TAX PRAC. & PROC., Dec. 2013-Jan. 2014, at 19 (providing practical advice for assisting sophisticated and unsophisticated taxpayers establish reasonable cause).

§ 12.02[C][2][b] (Defenses to the Penalty)

Revenue Procedure 2015-16, 2015-6 I.R.B. 596, is the most recent update to Revenue Procedure 2008-14 (in the text); it identifies circumstances under which disclosure of an item on a taxpayer’s return is adequate for purposes of reducing the substantial understatement portion of the accuracy-related penalty or avoiding certain tax return preparer penalties. The changes reflected in Revenue Procedure 2015-16 are primarily editorial and do not affect the discussion in the text.

§ 12.02[C][3] (Valuation Misstatements)

The Supreme Court’s decision in *United States v. Woods*, 134 S. Ct. 557 (2013), resolves a split among the circuits on the question of whether the gross valuation misstatement penalty applies to an underpayment resulting from a determination that a transaction lacks economic substance because the sole purpose of the transaction was to generate a tax loss by artificially inflating a taxpayer's basis in property. The taxpayer in *Woods* invested in a tax shelter transaction through a partnership. *Id*. at 560. The IRS disallowed losses flowing from the transaction on the ground that the transaction lacked economic substance. *Id.* at 561. The IRS also imposed a 40% gross valuation misstatement penalty under Code section 6662(h). *Id.* at 562. The District Court held that when the IRS totally disallows a deduction, it may not impose a penalty for a valuation overstatement included in the deduction. *Id.* In an unpublished opinion, the Fifth Circuit affirmed. *Id*.

Along with the Ninth, the Fifth Circuit in *Woods* maintained the minority view that the valuation misstatement penalty does not apply to transactions that lack economic substance. According to these courts, the penalty applies only when there is an underpayment specifically attributable to a valuation overstatement. *See, e.g.*, Gainer v. Commissioner, 893 F.2d 225 (9th Cir. 1990). In contrast, eight other circuit courts of appeal had held that when an underpayment arises from disallowed deductions from a transaction lacking economic substance, the underpayment is attributable to an overstatement and the penalty may apply. *See, e.g.*, Gustashaw v. Commissioner, 696 F.3d 1124 (2012) (citing cases following the majority rule).

In an unanimous decision, the U.S. Supreme Court rejected the view held by the Fifth and Ninth Circuits, holding instead that a determination that a transaction lacks economic substance can result in a valuation misstatement. According to the Court, "[T]he partners underpaid their taxes because they overstated their outside basis, and they overstated their outside basis because the partnerships were shams. We therefore have no difficulty concluding that any underpayment resulting from the . . . tax shelter is attributable to the partners' misrepresentation of outside basis (a valuation misstatement)." *Woods*, 134 S. Ct. at 568.

The Supreme Court's decision in *Woods* presumably overrules the Fifth Circuit's interpretation in *Heasley v. Commissioner*, 902 F.2d 380 (1990), reproduced in the text starting on page 488. For an in-depth discussion of *Woods*, see Karen C. Burke & Grayson M.P. McCouch, Woods: *A Path Through the Penalty Maze*, 142 TAX NOTES 829 (2014). On a related note, the Tax Court has held that a taxpayer cannot avoid the gross valuation misstatement penalty by conceding a deduction or credit on grounds unrelated to the value of basis of property. AHG Investments LLC v. Commissioner, 140 T.C. 73 (2013).

§ 12.02[E] (Information Reporting Penalties)

Congress increased penalties for noncompliance with information return reporting obligations, effective for information returns filed on or after January 1, 2011. *See* Small Business Jobs Act of 2010, Pub. L. No. 111-240 [hereinafter SBJA]. A payor who fails to file a correct information return before August 1 is subject to a penalty of $100 per return, up to a maximum of $1.5 million per calendar year. I.R.C. § 6721(a). The aggregate per-year penalty drops to $500,000 for small businesses, defined as those with less than $5 million in gross receipts. I.R.C. § 6721(d)(1). As before, the penalty amounts decrease for payors who correct errors. For returns filed up to 30 days after the due date, the penalty is $30 per return, up to a maximum of $250,000 per calendar year ($75,000 for small businesses). I.R.C. § 6721(b)(1), (d)(1)(B). For returns filed after 30 days following the due date but on or before August 1, the penalty is $60 per return, up to a maximum of $500,000 per calendar year ($200,000 for small businesses). I.R.C. § 6721(b)(2), (d)(1)(C).

As part of the SBJA, Congress also increased the penalties for failure to furnish an accurate payee statement. For statements required to be filed on or after January 1, 2011, the penalty is $100 per statement, up to a maximum penalty amount of $1.5 million per year. I.R.C. § 6722(a). Unlike prior law, the penalty may be reduced for prompt corrections. Corrected statements filed up to 30 days after the due date carry a penalty of $30 per statement and those filed after 30 days but on or before August 1 carry a penalty of $60 per statement. I.R.C. § 6722(b).

The SBJA legislation also included revisions to Code section 6045, which now requires third-party brokers to report to their clients the clients' tax bases in their investments, any resulting gains and losses during the year, and whether the gains or losses were long-term or short-term. I.R.C. § 6045(g)(2)(A). For a discussion of the potential information reporting penalty exposure associated with the section 6045 obligation, see Jay A. Soled et al., *Penalty Exposure for Incorrect Tax Basis Reporting on Information Returns*, 119 J. TAX'N 82 (2013).

§ 12.03 (PREPARER PENALTIES)

Replace the existing text in Section 12.03 with the following:

Reading Assignment: I.R.C. §§ 6694(a)-(b), 6695A, 7701(a)(36).

Tax return preparer penalties are designed to buttress the penalty structure that applies to taxpayers. In particular, the rules seek to discourage practitioners from cooperating with taxpayers who seek to underreport their liabilities and to prevent practitioners from encouraging inaccurate reporting. If a tax return preparer knows (or reasonably should know) that an understatement on the taxpayer's return is due to an "unrealistic position," the preparer is subject to a penalty equal to the greater of $1,000 or 50 percent of advisor's fees derived from preparing the return. I.R.C. § 6694(a)(1).

Prior to the 2008 amendments to section 6694, an unrealistic position, if not disclosed by the taxpayer, was one that had no realistic possibility of being sustained on the merits. A position was considered to have a realistic possibility of being sustained on its merits "if a reasonable and well-informed analysis by a person knowledgeable in the tax law would lead such a person to conclude that the position has approximately a one in three, or greater, likelihood of being sustained on its merits (realistic possibility standard)." Treas. Reg. § 1.6694-2(b) (prior to amendment). In applying this 1-in-3 standard, the possibility that the return would not be audited or, if audited, the issue would not be raised, was not taken into account. *Id.*[18]

[18] An individual who consistently engages in the type of conduct giving rise to the section 6694 penalty may be enjoined by the IRS from acting as a tax return preparer. I.R.C. § 7407.

The Emergency Economic Stabilization Act of 2008, P.L. 110-343, revised Code section 6694(a), which now provides as follows:

§ 6694. Understatement of taxpayer's liability by tax return preparer.

(a) *Understatement due to unreasonable positions*.
(1) *In general*. If a tax return preparer—
(A) prepares any return or claim of refund with respect to which any part of an understatement of liability is due to a position described in paragraph (2), and
(B) knew (or reasonably should have known) of the position,
such tax return preparer shall pay a penalty with respect to each such return or claim in an amount equal to the greater of $1,000 or 50 percent of the income derived (or to be derived) by the tax return preparer with respect to the return or claim.
(2) *Unreasonable position*.
(A) *In general*. Except as otherwise provided in this paragraph, a position is described in this paragraph unless there is or was substantial authority for the position.
(B) *Disclosed positions*. If the position was disclosed as provided in section 6662(d)(2)(B)(ii)(I) and is not a position to which subparagraph (C) applies, the position is described in this paragraph unless there is a reasonable basis for the position.
(C) *Tax shelters and reportable transactions*. If the position is with respect to a tax shelter (as defined in section 6662(d)(2)(C)(ii)) or a reportable transaction to which section 6662A applies, the position is described in this paragraph unless it is reasonable to believe that the position would more likely than not be sustained on its merits.
(3) *Reasonable cause exception*. No penalty shall be imposed under this subsection if it is shown that there is reasonable cause for the understatement and the tax return preparer acted in good faith.

The 2008 amendments apply to most returns prepared after May 25, 2007. If the position relates to a tax shelter, however, the amendment applies to returns prepared for tax years ending after October 3, 2008, the date of enactment of the 2008 legislation.[19]

Thus, under current law, the tax return preparer may be subject to a penalty if the position that creates the tax understatement *is not disclosed*; the preparer "knew (or reasonably should have known) of the position"; *and* the position is not supported by "substantial authority." I.R.C.

[19] Congress amended section 6694 in 2007 and it is these amendments that are discussed in the text, rather than the 2008 amendments, discussed above, which occurred while the text was in press. The 2007 amendments to section 6694 imposed a "more-likely-than-not" standard for undisclosed positions and a "reasonable basis" standard for disclosed positions. As reflected above, the 2008 amendments retain the reasonable basis standard for most disclosed positions. For most undisclosed positions, the 2008 amendments lower the expected standard from more-likely-than-not to "substantial authority." However, for tax shelter-type transactions, the more-likely-than-not standard still controls.

§ 6694(a)(1), (2)(A). If the position that creates the tax understatement *is disclosed*, the preparer may be penalized if the preparer knew, or reasonably should have known of the position; and there was no "reasonable basis" for the position. I.R.C. § 6694(a)(2)(B). For a tax shelter item, the tax return preparer may be subject to a penalty if the taxpayer knew or reasonably should have known of the position; and the preparer did not reasonably believe that the position would "more likely than not" be sustained on its merits. I.R.C. § 6694(a)(2)(C).

The "substantial authority" standard has the same meaning as it does for purposes of applying the accuracy-related penalty in section 6662. *See* Notice 2009-5, 2009-3 I.R.B. 309 (citing Treas. Reg. § 1.6662-4(d)). It is an objective standard that is less stringent than the more-likely-than-not standard (requiring a greater than 50 percent likelihood that the position will be upheld), but more stringent than the reasonable basis standard. *See* Treas. Reg. § 1.6662-4(d)(2). The "reasonable basis" standard is also defined with reference to the accuracy-related penalty and requires something more than a merely arguable or colorable claim. *See* Treas. Reg. § 1.6662-3(b)(3).[20]

In assessing exposure to these penalties, to what extent must the return preparer verify the information provided by the taxpayer? As a general rule, a preparer may rely in good faith on information furnished by the taxpayer, and need not review the taxpayer's books and records for accuracy and completeness. Also, a tax return preparer may rely in good faith and without verification upon information furnished by another advisor, another tax return preparer, or other third party. Treas. Reg. § 1.6694-1(e)(1). Although a return preparer is not required to independently verify information provided by the taxpayer or a third party, the penalty may apply where the preparer fails to inquire as to furnished information that appears, based upon facts actually known to the preparer, to be incomplete or incorrect. Moreover, if a Code provision requires that the taxpayer maintain specific documents to substantiate a deduction or credit, the return preparer must make appropriate inquiries to determine whether those documents exist. *Id*. Treasury Regulations provide the following two examples:

> *Example 1*: During an interview conducted by Preparer E, a taxpayer stated that he had made a charitable contribution of real estate in the amount of $50,000 during the tax year, when in fact he had not made this charitable contribution. E did not inquire about the existence of a qualified appraisal or complete a Form 8283, Noncash Charitable Contributions, in accordance with the reporting and substantiation requirements under section 170(f)(11). E reported a deduction on the tax return for the charitable contribution, which resulted in an understatement of liability for tax, and signed the tax return as the tax return preparer. E is subject to a penalty under section 6694.
>
> *Example 2*: While preparing the 2008 tax return for an individual taxpayer, Preparer F realizes that the taxpayer did not provide a Form 1099-INT, "Interest Income", for a bank account that produced significant taxable income in 2007.

[20] Increased penalty amounts (the greater of $5,000 or 50 percent of the income derived or to be derived) apply to preparer conduct that is willful or reckless. I.R.C. § 6694(b).

> When F inquired about any other income, the taxpayer furnished the Form 1099-INT to F for use in preparation of the 2008 tax return. F did not know that the taxpayer owned an additional bank account that generated taxable income for 2008, and the taxpayer did not reveal this information to the tax return preparer notwithstanding F's general inquiry about any other income. F signed the taxpayer's return as the tax return preparer. F is not subject to a penalty under section 6694.

Treas. Reg. § 1.6694-1(e)(3) Ex. 1 & 2. *See also* Paul J. Lee, *Tax Preparer Penalties for Relying on Incorrect Client Information*, TAXES, July 2013, at 49 (examining ethical considerations, as well as penalty and malpractice exposure, for practitioners who rely on information provided by clients without verification).

The penalty in section 6694 applies not just to those who prepare income tax returns, but also to preparers of amended returns and claims for refund; estate and gift tax returns; excise tax returns; and employment tax returns. Moreover, a person may qualify as a tax return preparer even if the person does not sign the return and even if he or she renders advice with respect to only one entry on the return, if the entry constitutes a "substantial portion" of the return.[21] *See* Treas. Reg. § 301.7701-15(b)(2), (3). Someone who provides tax planning advice, however, generally will not be subject to the penalty. According to the regulations, a person who gives advice but does not sign the return is considered a tax return preparer only if the advice is given with respect to events that have already occurred at the time the advice is rendered. *See id.* The regulations include the following example:

> *Example 2:* Attorney B, an attorney in a law firm, provides legal advice to a large corporate taxpayer regarding the tax consequences of a proposed corporate transaction. Based upon this advice, the corporate taxpayer enters into the transaction. Once the transaction is completed, the corporate taxpayer does not receive any additional advice from B with respect to the transaction. B did not provide advice with respect to events that have occurred and is not considered a tax return preparer.

Treas. Reg. § 301.7701-15(b)(2)(ii) Ex. 2.

A person's status as a tax return preparer does not take into account educational qualifications or professional status. I.R.C. § 7701(a)(36); Treas. Reg. § 301.7701-15(d). In Revenue Ruling 86-55, 1986-1 C.B. 373, for example, the IRS ruled that a used car dealership that offered to prepare returns free of charge to customers who purchased an automobile from the

[21] Treasury regulations distinguish between a "signing" and a "nonsigning" tax return preparer. Treas. Reg. § 301.7701-15(b)(3). A signing preparer is the individual who has primary responsibility for the overall substantive accuracy of the return. A nonsigning preparer is a preparer who is not the signing preparer but who prepares all or a substantial portion of the return. For a nonsigning preparer, an entry or portion of a return is not considered substantial if the entry involves amounts of gross income or deductions that are (1) less than $10,000, or (2) less than $400,000 and also less than 20 percent of the gross income (adjusted gross income if the taxpayer is an individual) as shown on the return. *Id.*

dealership with the resulting refund was an income tax return preparer. Chapter 18 discusses in more detail the relationship among the return preparer penalty, the ethical standards for tax practitioners set forth in American Bar Association guidance, and the standards of conduct for those practicing before the IRS in Treasury Circular 230.

In 2006, Congress created a separate civil penalty that applies to appraisers who prepare a valuation appraisal if: (1) the appraiser knows, or reasonably should have known, that the appraisal would be used in connection with a federal tax return or refund claim; and (2) the claimed value of the appraised property results in a substantial valuation misstatement related to income tax under section 6662(e) or a gross valuation misstatement under section 6662(h). I.R.C. § 6695A(a) (applicable to appraisals prepared with respect to returns filed after August 17, 2006). The section 6695A penalty is the lesser of two amounts: (1) the greater of $1,000 or 10 percent of the tax underpayment attributable to the valuation misstatement; or (2) 125 percent of the gross income received by the appraiser for preparing the appraisal. I.R.C. § 6695A(b). The appraiser may avoid the penalty if he or she can establish that the appraised value was more likely than not the proper valuation. I.R.C. § 6695A(c).

§ 12.04[A] (Tax Shelter Organizers and Promoters)

In 2014, the Treasury Department finalized regulations under Code section 6707, which imposes penalties on material advisors who fail to disclose information relating to reportable transactions. I.R.C. § 6707(a). The penalty for material advisors who fail to disclose a reportable transaction is $50,000 for each failure. I.R.C. § 6707(b)(1). For a listed transaction, the penalty increases to $200,000 or 50% of the material advisor's gross income from the transaction. I.R.C. § 6707(b)(2). The final regulations clarify that, when a transaction is both a listed transaction and a reportable transaction, only one penalty—the higher one for listed transactions—applies. The regulations also confirm that a material advisor is liable for a separate penalty for each reportable or listed transaction in which she is involved. *See* T.D. 9868, 79 Fed. Reg. 44282.

§ 12.04[B] (Tax Shelter Investors)

The Small Business Jobs Act of 2010, Pub. L. No. 111-240, modified in several respects the penalty in section 6707A imposed on taxpayers that fail to disclose participation in a tax shelter-type (reportable or listed) transaction. As a general rule, the penalty equals 75 percent of the decrease in tax shown on the return resulting from the reportable transaction. A minimum penalty of $5,000 in the case of an individual ($10,000 for all other taxpayers) applies. The amendments also create a maximum penalty equal to $10,000 for individuals who fail to disclose a reportable transaction ($50,000 for all other taxpayers) and $100,000 for individuals who fail to disclose a listed transaction ($200,000 for all other taxpayers). The modifications to section 6707A apply retroactively to penalties assessed after December 31, 2006. The Treasury Department has incorporated these statutory revisions into finalized regulations under section 6707A. *See* T.D. 9550, 2011-2 C.B. 785.

§ 12.05 (ASSESSMENT, ABATEMENT, AND SUSPENSION OF PENALTIES)

In the first paragraph on page 504 of the text, replace the citations to the Internal Revenue Manual as follows: (1) The cite to IRM 20.1.1.4. should be to 20.1.2.1.4.; (2) The cite to IRM 20.1.1.4.1.2. should be to 20.1.2.1.4.1.

Chapter 13

§ 13.02[B][2] (Possible Suspension Periods)

The Treasury Department has finalized regulations under section 6404(g) relating to interest and penalty suspensions. T.D. 9545, 2011-2 C.B. 490. The regulations are consistent with earlier proposed regulations, mentioned in the text, and are also consistent with Notice 2007-93, also mentioned in the text, which provides guidance on how the 2007 amendments to section 6404(g) apply to notices provided after November 25, 2007 with respect to individual tax returns timely filed on or before that date.

In *Corbalis v. Commissioner*, 142 T.C. 46 (2014), the Tax Court held that the IRS's denial of the taxpayers' interest suspension claim under Code section 6404(g) is subject to judicial review under Code section 6404(h). The dispute arose because section 6404(h) grants the Tax Court jurisdiction over actions brought by taxpayers to review denials of interest abatement requests. I.R.C. § 6404(h)(1). Section 6404(g), by contrast, is described in the statute as an interest suspension provision. I.R.C. § 6404(g)(1)(A)(ii). The court rejected any jurisdictional distinction between abatement and suspension, noting that the IRS's position ignores "a strong presumption that the actions of an administrative agency are subject to judicial review." *Id*. at *21. The court also ruled that the IRS's position in Revenue Procedure 2005-38, 2005-2 C.B. 81, that interest suspension under section 6404(g) is not entitled to judicial review, deserved no deference: "A procedural pronouncement cannot restrict or revise section 6404(h). See Commissioner v. Schleier, 515 U.S. 323, 336 n.8, . . . ; Estate of Kunze v. Commissioner, 233 F.3d 948, 952 (7th Cir. 2000), *aff'g* T.C. Memo. 1999-344. The wording and context of the statute, supplemented by more general legal principles, control." *Corbalis, supra*, at 54.

To qualify for judicial review under section 6404(h), the taxpayer must satisfy the net worth requirements in Code section 7430(c)(4)(A)(ii). I.R.C. § 6404(h)(1). The Tax Court in *Corbalis* left open the question of whether the section 7430 net worth limitation should be determined based on the fair market value of the taxpayer's assets or their acquisition costs. *Corbalis*, *supra*, at 58–59. Tax Court precedent exists for either position. *Compare* Swanson v. Comm'r, 106 T.C. 76 (1996) (utilizing acquisition cost to determine net worth) *with* Powers v. Comm'r, 100 T.C. 457 (1993) (utilizing fair market value).

§ 13.02[D][1] (Advance Remittances)

A Chief Counsel Notice issued in 2009, CC-2010-002, *available at* 2009 TAX NOTES TODAY 232-18 (2009), provides some helpful examples illustrating how interest accrues on section 6603 deposits:

> *Example 1.* Assume that a taxpayer receives a 30 day letter proposing a deficiency in the amount of $1 million. The amount of the disputable tax is $1 million. The taxpayer subsequently remits a section 6603 deposit in that amount. When the dispute is resolved, however, the Service assesses $900,000. The

> taxpayer is entitled to section 6603 interest on the difference between the disputable tax and the actual liability, which is $100,000. The taxpayer is not entitled to section 6611 interest on the $100,000.
>
> *Example 2.* Assume as above that the disputable tax is $1 million, but that the taxpayer makes a section 6603 deposit in the amount of $1.2 million. The Service assesses $900,000 upon resolution of the dispute. As in the above example, the taxpayer is entitled to section 6603 interest on $100,000, the difference between the disputable tax and the amount of the assessment. The taxpayer is not entitled to interest under either section 6603 or section 6611 on the $200,000 difference between the disputable tax and the amount remitted because this amount is not attributable to a disputable tax.

Id.

The same Chief Counsel Notice clarifies the status of a section 6603 deposit after the IRS uses a portion of the deposit to satisfy an assessment:

> Section 4.02(1) of Rev. Proc. 2005-18 provides, in relevant part, that upon completion of an examination, if the taxpayer consents to an assessment of the full amount of the deficiency, "an assessment will be made and any deposit will be applied . . . as a payment of tax as of the date the assessment was made." Section 6.01 of Rev. Proc. 2005-18 provides that a taxpayer may request the return of a deposit at any time before the Service has used the deposit for a payment of tax.
>
> When an assessment is made, and a section 6603 deposit is used to satisfy the assessment, the remittance is treated as a payment. The legal character of the entire deposit is not changed to a payment. If the legal character of the entire deposit is changed to a payment by the application of the section 6603 deposit to the liability, the taxpayer would be required to recover the excess deposit by suit for refund. This requirement would be facially inconsistent with section 6603(c), which allows the taxpayer to request return of the section 6603 deposit in writing without following claim for refund procedures. Further, converting the character of the entire deposit to that of payment would render section 6603 moot and would be inconsistent with the legislative intent of sections 6603 and 6611.
>
> Therefore, when a taxpayer requests the return of the "excess" section 6603 deposit (i.e., the section 6603 deposit remaining after an assessment of tax) the excess amount is still a section 6603 deposit and is not a payment subject to interest under section 6611. To the extent attributable to a disputable tax, the "excess" deposit would retain its character as a deposit and earn section 6603

> deposit interest from the deposit date to the date it is returned to the taxpayer, but not overpayment interest under section 6611.

Id. (footnotes omitted).

An issue not addressed by Revenue Procedure 2005-18, 2005-1 C.B. 798, or by Chief Counsel Notice 2010-02, is whether a taxpayer can unilaterally convert a Section 6603 deposit into an advance payment of tax (rather than requesting its return). A decision by the Court of Federal Claims, *Principal Life Ins. Co. v. United States*, 95 Fed. Cl. 786 (2010), held that, because Revenue Procedure 2005-18 does not allow it, a taxpayer cannot, without the IRS's permission, convert a section 6603 deposit into an advance payment. *Id*. at 798–99. As commentators have pointed out, however, the taxpayers in *Principal Life* argued that the conversion resulted in a barred assessment, which, according to the taxpayers, converted the advance payments into statutory overpayments under section 6401. Michael A. Urban & Arrington Booker, *Unresolved Issues Regarding Sec. 6603 Deposits*, 44 TAX ADVISER 444 (2013). The court denied that characterization but, according to Urban and Booker: "Such facts seem distinguishable from a situation in which a taxpayer, after making the original deposit, simply changes its mind as to how it wants the remittance characterized (i.e., as an advance payment) because it decides that it no longer wishes to administratively contest the underlying tax issues." *Id*. at 444.

If a taxpayer is permitted to convert a deposit to a payment, what interest rate would apply to the returned amounts? In *Ford Motor Co. v. United States*, 2012 U.S. App. LEXIS 25725 (6th Cir. 2012), vacated, 134 S. Ct. 510 (2013), the taxpayer made a series of cash deposits and then requested that the deposits be converted to advance payments. A portion of those payments ultimately was refunded to the taxpayer. *Id*. at *507. The Sixth Circuit affirmed the District Court's ruling that the taxpayer was entitled to overpayment interest only from the date of conversion to the date of the refund. While the deposits pre-dated the enactment of Code section 6603, the taxpayer maintained that the principles espoused in section 6603 supported its position that interest should accrue from the date it submitted the deposits. The Sixth Circuit disagreed:

> Ford contends that since § 6603 allows a taxpayer who requests the return of his deposit to recover interest from the remittance date, it makes little sense to interpret § 6611 to allow a taxpayer who converts a deposit—rather than asking for its return—to recover interest only from the conversion date. According to Ford, a taxpayer who requests the return of a deposit would then be entitled to interest from an earlier date than the taxpayer who requests that a deposit be converted, thus illogically rewarding the taxpayer who seeks the return of his deposit over the taxpayer who actually converts his deposit into an advance payment of tax. The government responds that a converted deposit is actually two sequential transactions—a constructive return of the deposit followed by immediate re-submission of that deposit as a tax payment. Under this reasoning, §

> 6603 requires that the taxpayer be paid interest from the date of deposit to the date of return under the lower § 6603(d)(4) interest rate, and be paid interest from the date of return (which is also the date of resubmission) to the date of refund under the higher § 6621(a)(1) interest rate. In other words, § 6603 allows for the payment of interest at two different rates for a converted deposit, while prior to the enactment of § 6603, interest would only be paid from the date of conversion forward.

Id. at *515–16. On appeal, the Supreme Court vacated the Sixth Circuit's opinion because of jurisdictional issues that are discussed in Section 10.03[A][2] of this Supplement. *Ford Motor Co.*, 134 S. Ct. at 511.

On remand, the Sixth Circuit resolved the jurisdictional issues and again disagreed with Ford's contention that it was entitled to overpayment interest back to the date the deposit was submitted rather than the date it was converted to an advance payment. Ford Motor Co. v. United States, 768 F.3d 580 (6th Cir. 2014). As before, the court was not swayed by the fact that section 6603, enacted after Ford made its deposit, would provide a different result:

> Both Ford and the United States advance interpretations of § 6611 that would reconcile that statute and § 6603 with the IRS's apparent practice of converting deposits into advance tax payments. Yet § 6603 had not been enacted when Ford remitted its deposits, so we need not concern ourselves with the effect of that statute on the facts of this case. Taxpayers who remit deposits today may conclude that they can maximize their interest by requesting the return of their deposits instead of converting those deposits into advance tax payments. That choice was not available to Ford, however, and we will not adopt a warped interpretation of § 6611 merely to allow Ford to recoup interest that Congress only recently decided to award.

Id.

Chapter 14

§ 14.02[A] (The IRS's Collection Operation)

In March 2009, the IRS announced that it would not renew expiring contracts with private debt collection agencies, thereby effectively ending its private debt collection program. I.R.S. News Release IR-2009-19 (Mar. 5, 2009), *available at* http://www.irs.gov/uac/IRS-Conducts-Extensive-Review,-Decides-Not-to-Renew-Private-Debt-Collection-Contracts. Relying in part on results from an IRS study, then-IRS Commissioner Shulman concluded that "when working similar inventory, IRS collection is more cost effective than using outside contractors." *See* Diana Freda, *Shulman Formally Announces End of Private Debt Collection Program*, DAILY TAX REP. (BNA), Mar. 9, 2009, at G-6. Code section 6306, which authorizes the IRS to use private entities to collect tax delinquencies, is still on the books, so the program could be revived in the future. In fact, Senate Republicans recently proposed the use of private debt collection agencies, maintaining that the move could generate $2 billion in additional revenue over the next 10 years. Zach Carter, *Republicans Want Private Debt Collectors to Replace IRS Agents*, HUFFINGTON POST, July 23, 2015, *available at* http://www.huffingtonpost.com/entry/republicans-private-debt-collection-irs_55b1570de4b07af29d580b9f.

§ 14.03[B][1] (Release and Discharge)

In June 2010, the IRS released a new form for requesting a release of a federal tax lien. Instead of relying on the series of Forms 669 to request a lien discharge, the taxpayer now uses Form 14135, *Application for Certificate of Discharge of Property from Federal Tax Lien*, in most instances. *See* I.R.S. Publication 783 (Rev. 6-2010), *available at* http://www.irs.gov/pub/irs-pdf/p783.pdf.

In light of the struggling economy, the IRS announced procedures making it easier for taxpayers to obtain lien withdrawals. *See* I.R.S. News Release IR-2011-20 (Feb. 24, 2011), *available at* http://www.irs.gov/uac/IRS-Announces-New-Effort-to-Help-Struggling-Taxpayers-Get-a-Fresh-Start%3b-Major-Changes-Made-to-Lien-Process. The IRS will accelerate lien withdrawals once the taxpayer has fully paid the liability if the taxpayer requests the relief on Form 12277, *Application for Withdrawal*. If the taxpayer has not fully paid the tax liability, the IRS may be willing to withdraw a lien on unpaid amounts of $25,000 or less if the taxpayer agrees to enter into an installment agreement under which the IRS directly debits the payments from the taxpayer's bank account. The IRS also announced that will increase the dollar threshold for when it files a Notice of Federal Tax Lien from $5,000 to $10,000.

A recent Tax Court opinion makes it clear that the decision to withdraw a Notice of Federal Tax Lien is squarely within the IRS's discretion, making the IRS's more generous current position particularly important. In *Kehoe v. Commissioner*, T.C. Memo. 2013-63, 2013 Tax Ct. Memo LEXIS 77, the court declined to overturn the decision of the Appeals Officer who refused the taxpayer's request to withdraw the lien made as part of a Collection Due Process hearing:

> Petitioners contend that respondent abused his discretion in failing to withdraw the NFTL for tax year 2005. Under section 6323(j), the Commissioner has the discretion to withdraw an NFTL if: (1) the filing was premature or not in accordance with administrative procedures; (2) the taxpayer enters into an installment agreement to pay the tax, unless the agreement requires that the lien remain filed; (3) the withdrawal of the lien would facilitate the collection of the tax; or (4) the withdrawal of the lien would be in the best interest of the taxpayer, as determined by the National Taxpayer Advocate, and of the United States. *See also* sec. 301.6323(j)-1(a), Proced. & Admin. Regs.
>
> In Hughes v. Commissioner, T.C. Memo. 2011-294, this Court sustained a filed NFTL where the taxpayer alleged that the filing should have been withdrawn because it impaired his credit. In that opinion the Court stated that the impairment of credit by itself does not impair the taxpayer's ability to satisfy his tax liability. *Id.* Additionally, the Court noted that the taxpayer's long history of noncompliance supported the notion that the filed NFTL was necessary to protect the Government's interest in the taxpayer's property.
>
> In a similar case, this Court again sustained a filed NFTL where the taxpayer alleged that the filing had impaired his ability to pay because he could not obtain a loan to satisfy the liability. Berkery v. Commissioner, T.C. Memo. 2011-57. The Court stated that the taxpayer had not established that the NFTL filing had impaired his ability to pay the liability because he had not presented any evidence that he had been rejected for a loan as a result of the NFTL. The Court noted that the taxpayer had almost two years before the filing of the NFTL, during which he made no effort to pay any of his outstanding tax liability, and that his payment history "casts doubt on the good faith of his efforts to pay." Id.
>
> The Court in both instances noted that lien withdrawal is permissive. Although section 6323(j)(1) allows the Commissioner to withdraw an NFTL for any of the reasons stated above, it does not require him to do so. The regulations make the Commissioner's discretion explicit: "If the Commissioner determines conditions for withdrawal are present, the Commissioner may (but is not required to) authorize the withdrawal." Sec. 301.6323(j)-1(c), Proced. & Admin. Regs.
>
> Petitioners argue that the filing of the NFTL impaired their ability to pay the outstanding liability. Specifically, the financial impact of the NFTL left them in a position where they could no longer make the monthly installment payments or borrow funds to pay the liability in full.

> Petitioners are unlike the taxpayers in Berkery and Hughes. Before 2005, petitioners had never failed to pay their Federal income tax. Even for the year at issue, petitioners correctly self-reported their income and timely filed their Federal income tax return. They did not pay their liability in full because they had expended their available funds in dealing with an ongoing family crisis. Despite being in a tight financial position, petitioners still made efforts to pay down their liability whenever possible.
>
> * * *
>
> The Court notes that petitioners were certainly financially disadvantaged by the filing of the NFTL. Additionally the Court notes that petitioners have no history of noncompliance and appear to have dealt with [the Appeals Officer] in good faith. However, it is clear that regardless of the presence of circumstances adequate to allow withdrawal of the NFTL, withdrawal is left in the discretion of the settlement officer. Accordingly, it was not an abuse of discretion for [the Appeals Officer] to refuse to withdraw the NFTL.

Id. at *4–5.

§ 14.03[C][1] (Notice of Intent to Levy)

In the last paragraph on page 563, the cite to the Internal Revenue Manual should be revised to read as follows: IRM 5.10.2.1.

§ 14.03[C][3] (Levy and Seizure)

Chief Counsel Advice Memorandum 200926001 (Jan. 9, 2009), *available at* http://www.irs.gov/pub/irs-wd/0926001.pdf, determined that the IRS is authorized to seize stock options held by a delinquent taxpayer and to sell those options to a third party regardless of any restrictions on the options' transferability. The taxpayer held nonqualified stock options, which were subject to contractual restrictions on transfer, and incentive stock options, which included transfer restrictions mandated by Code section 422. The memorandum concluded that section 6331 supersedes both the contractual and statutory restrictions on transfer.

§ 14.04[A] (Judicial Proceedings Instituted by the Government)

For an interesting take on the *Rodgers* decision, included in the text, by the attorney who represented Mrs. Rogers, see William D. Elliott, *IRS Foreclosure Power:* Rodgers *30 Years Later*, TAXES, July 2013, at 19. The author fills in several details about the case that are not included in the opinion, including how the husband's tax liability arose (alleged gambling activity) and how the case was concluded on remand (settlement allowing Mrs. Rodgers two years to sell the home with the proceeds being split 50/50 between her and the government).

PROBLEMS

On page 589, replace the first sentence of Problem 2 with the following: On May 1, Year 1, the IRS mailed to Molly's last known address a statutory notice of deficiency for a $10,000 income tax liability.

Chapter 15

§ 15.01 (INTRODUCTION)

In January 2009, as the U.S. economic crisis worsened, the IRS announced a series of programs to assist economically distressed taxpayers with delinquent accounts. *See* I.R.S. News Release IR-2009-2 (Jan. 6, 2009) (updated Nov. 3, 2014), *available at* http://www.irs.gov/uac/IRS-Begins-Tax-Season-2009-with-Steps-to-Help-Financially-Distressed-Taxpayers;-Promotes-Credits,-e-File-Options. The News Release states:

> Among the areas in which the IRS can provide assistance:
>
> > Postponement of Collection Actions**:** IRS employees will have greater authority to suspend collection actions in certain hardship cases where taxpayers are unable to pay. This includes instances when the taxpayer has recently lost a job, is relying solely on Social Security or welfare income or is facing devastating illness or significant medical bills. If an individual has recently encountered this type of financial problem, IRS assistors may be able to suspend collection without documentation to minimize burden on the taxpayer.
> >
> > Added Flexibility for Missed Payments**:** The IRS is allowing more flexibility for previously compliant individuals in existing Installment Agreements who have difficulty making payments because of a job loss or other financial hardship. The IRS may allow a skipped payment or a reduced monthly payment amount without automatically suspending the Installment Agreement. Taxpayers in a difficult financial situation should contact the IRS.
> >
> > Additional Review for Offers in Compromise on Home Values**:** . . . With the uncertainty in the housing market, the IRS recognizes that the real-estate valuations used to assess ability to pay may not be accurate. So in instances where the accuracy of local real-estate valuations is in question or other unusual hardships exist, the IRS is creating a new second review of the information to determine if accepting an offer is appropriate.
> >
> > Prevention of Offer in Compromise Defaults**:** Taxpayers who are unable to meet the periodic payment terms of an accepted OIC will be able to contact the IRS office handling the offer for available options to help them avoid default.

Id. A Treasury Inspector General report concluded that the IRS generally had effectively implemented the new programs. *See* TIGTA, *Collection Alternatives Were Available to Economically Distressed Taxpayers, but Some New Processes Need Improvement*, Ref. No.

2010-30-032 (Mar. 15, 2010), *available at* http://www.treasury.gov/tigta/auditreports/2010reports/201030032fr.pdf.

§ 15.03 (INSTALLMENT AGREEMENTS)

The Treasury Department has released final regulations under Code section 6159 relating to installment agreements. The regulations, which are effective November 25, 2009, replace proposed regulations issued in 2007. T.D. 9473, 2009-52 I.R.B. 945.

The final regulations are largely consistent with the proposed regulations, which are cited throughout Section 15.03. Except as provided below, all references in Section 15.03 to proposed regulations should be replaced with references to final regulations.

For installment agreements filed on or after January 1, 2014, the user fee increases from $105 to $120. *See* T.D. 9647, 2013-2 C.B. 816, 2013 IRB LEXIS 702 at *2 (amending 26 C.F.R. § 300.1(b)). According to the Treasury Decision, the full cost to the IRS of processing a request is $282. *Id.* at *3.

§ 15.03[A][1] (Automatic Acceptance)

In an effort to respond to the continuing downturn in the economy, the IRS announced in 2011 an expansion of its streamlined process for accepting installment agreements from small businesses. *See* I.R.S. News Release IR-2011-20 (Feb. 24, 2011), *available at* http://www.irs.gov/uac/IRS-Announces-New-Effort-to-Help-Struggling-Taxpayers-Get-a-Fresh-Start%3b-Major-Changes-Made-to-Lien-Process. Small businesses with $25,000 or less in unpaid taxes are now eligible to participate in the program, an increase from $10,000.

Under a more recent expansion of the streamlined installment agreement process, the IRS announced that it would generally accept installment agreements from individual taxpayers if the taxpayer has an outstanding balance of $50,000 of less (formerly $25,000) and agreed to pay the balance within a six-year period (formerly five). *See* IRS Memorandum (SBSE-05-0214-0017) Updating Streamlined Installment Agreement Criteria (Feb. 21, 2014), *available at* http://news.bna.com/tcln/TCLNWB/split_display.adp?fedfid=42229182&vname=txcnot&wsn=516288000&searchid=25522125&doctypeid=1&type=date&mode=doc&split=0&scm=TCLNWB&pg=0.

§ 15.03[A][2] (Conditional Acceptance)

Replace the version of Form 433-A in the text with the following:

Form **433-A**

(Rev. December 2012)

Department of the Treasury
Internal Revenue Service

Collection Information Statement for Wage Earners and Self-Employed Individuals

Wage Earners Complete Sections 1, 2, 3, 4, and 5 including the signature line on page 4. *Answer all questions or write N/A if the question is not applicable.*

Self-Employed Individuals Complete Sections 1, 3, 4, 5, 6 and 7 and the signature line on page 4. *Answer all questions or write N/A if the question is not applicable.*

For Additional Information, refer to Publication 1854, "How To Prepare a Collection Information Statement."

Include attachments if additional space is needed to respond completely to any question.

Name on Internal Revenue Service (IRS) Account	Social Security Number *SSN* on IRS Account	Employer Identification Number *EIN*

Section 1: Personal Information

1a Full Name of Taxpayer and Spouse *(if applicable)*	**1c** Home Phone ( )	**1d** Cell Phone ( )
1b Address *(Street, City, State, ZIP code) (County of Residence)*	**1e** Business Phone ( )	**1f** Business Cell Phone ( )
	2b Name, Age, and Relationship of dependent(s)	
2a Marital Status: ☐ Married ☐ Unmarried *(Single, Divorced, Widowed)*		

	Social Security No. *(SSN)*	Date of Birth *(mmddyyyy)*	Driver's License Number and State
3a Taxpayer			
3b Spouse			

Section 2: Employment Information for Wage Earners

If you or your spouse have self-employment income instead of, or in addition to wage income, complete Business Information in Sections 6 and 7.

Taxpayer		Spouse	
4a Taxpayer's Employer Name		**5a** Spouse's Employer Name	
4b Address *(Street, City, State, and ZIP code)*		**5b** Address *(Street, City, State, and ZIP code)*	
4c Work Telephone Number ( )	**4d** Does employer allow contact at work ☐ **Yes** ☐ **No**	**5c** Work Telephone Number ( )	**5d** Does employer allow contact at work ☐ **Yes** ☐ **No**
4e How long with this employer *(years)* *(months)*	**4f** Occupation	**5e** How long with this employer *(years)* *(months)*	**5f** Occupation
4g Number of withholding allowances claimed on Form W-4	**4h** Pay Period: ☐ Weekly ☐ Bi-weekly ☐ Monthly ☐ Other	**5g** Number of withholding allowances claimed on Form W-4	**5h** Pay Period: ☐ Weekly ☐ Bi-weekly ☐ Monthly ☐ Other

Section 3: Other Financial Information *(Attach copies of applicable documentation)*

6 **Are you a party to a lawsuit** *(If yes, answer the following)* ☐ **Yes** ☐ **No**

☐ Plaintiff ☐ Defendant	Location of Filing	Represented by	Docket/Case No.
Amount of Suit $	Possible Completion Date *(mmddyyyy)*	Subject of Suit	

7 **Have you ever filed bankruptcy** *(If yes, answer the following)* ☐ **Yes** ☐ **No**

Date Filed *(mmddyyyy)*	Date Dismissed *(mmddyyyy)*	Date Discharged *(mmddyyyy)*	Petition No.	Location Filed

8 **In the past 10 years, have you lived outside of the U.S for 6 months or longer** *(If yes, answer the following)* ☐ **Yes** ☐ **No**

Dates lived abroad: from *(mmddyyyy)*	To *(mmddyyyy)*

9a **Are you the beneficiary of a trust, estate, or life insurance policy** *(If yes, answer the following)* ☐ **Yes** ☐ **No**

Place where recorded:		EIN:
Name of the trust, estate, or policy	Anticipated amount to be received $	When will the amount be received

9b **Are you a trustee, fiduciary, or contributor of a trust** ☐ **Yes** ☐ **No**

Name of the trust:	EIN:

10 **Do you have a safe deposit box (business or personal)** *(If yes, answer the following)* ☐ **Yes** ☐ **No**

Location *(Name, address and box number(s))*	Contents	Value $

11 **In the past 10 years, have you transferred any assets for less than their full value** *(If yes, answer the following)* ☐ **Yes** ☐ **No**

List Asset(s)	Value at Time of Transfer $	Date Transferred *(mmddyyyy)*	To Whom or Where was it Transferred

Section 4: Personal Asset Information for All Individuals

12 **CASH ON HAND** Include cash that is not in a bank **Total Cash on Hand**	$

PERSONAL BANK ACCOUNTS Include all checking, online and mobile *(e.g., PayPal)* accounts, money market accounts, savings accounts, and stored value cards *(e.g., payroll cards, government benefit cards, etc.)*.

Type of Account	Full Name & Address *(Street, City, State, ZIP code)* of Bank, Savings & Loan, Credit Union, or Financial Institution	Account Number	**Account Balance** As of ______ *mmddyyyy*
13a			$
13b			$
13c			$
13d **Total Cash** *(Add lines 13a through 13c, and amounts from any attachments)*			$

INVESTMENTS Include stocks, bonds, mutual funds, stock options, certificates of deposit, and retirement assets such as IRAs, Keogh, and 401(k) plans. Include all corporations, partnerships, limited liability companies, or other business entities in which you are an officer, director, owner, member, or otherwise have a financial interest.

Type of Investment or Financial Interest	Full Name & Address *(Street, City, State, ZIP code)* of Company	Current Value	Loan Balance *(if applicable)* As of ______ *mmddyyyy*	**Equity** Value minus Loan
14a	Phone	$	$	$
14b	Phone	$	$	$
14c	Phone	$	$	$
14d **Total Equity** *(Add lines 14a through 14c and amounts from any attachments)*				$

AVAILABLE CREDIT Include all lines of credit and bank issued credit cards. Full Name & Address *(Street, City, State, ZIP code)* of Credit Institution	Credit Limit	Amount Owed As of ______ *mmddyyyy*	**Available Credit** As of ______ *mmddyyyy*
15a Acct. No	$	$	$
15b Acct. No	$	$	$
15c **Total Available Credit** *(Add lines 15a, 15b and amounts from any attachments)*			$

16a **LIFE INSURANCE** Do you own or have any interest in any life insurance policies with cash value (*Term Life insurance does not have a cash value)*

☐ **Yes** ☐ **No** If yes, complete blocks 16b through 16f for each policy.

16b Name and Address of Insurance Company(ies):			
16c Policy Number(s)			
16d Owner of Policy			
16e Current Cash Value	$	$	$
16f Outstanding Loan Balance	$	$	$
16g Total Available Cash *(Subtract amounts on line 16f from line 16e and include amounts from any attachments)*			$

REAL PROPERTY Include all real property owned or being purchased

	Purchase Date *(mmddyyyy)*	Current Fair Market Value (FMV)	Current Loan Balance	Amount of Monthly Payment	Date of Final Payment *(mmddyyyy)*	**Equity** FMV Minus Loan
17a Property Description		$	$	$		$
Location *(Street, City, State, ZIP code)* and County	Lender/Contract Holder Name, Address *(Street, City, State, ZIP code)*, and Phone Phone					
17b Property Description		$	$	$		$
Location *(Street, City, State, ZIP code)* and County	Lender/Contract Holder Name, Address *(Street, City, State, ZIP code)*, and Phone Phone					
17c Total Equity *(Add lines 17a, 17b and amounts from any attachments)*						$

PERSONAL VEHICLES LEASED AND PURCHASED Include boats, RVs, motorcycles, all-terrain and off-road vehicles, trailers, etc.

Description (Year, Mileage, Make/Model, Tag Number, Vehicle Identification Number)		Purchase/ Lease Date *(mmddyyyy)*	Current Fair Market Value (FMV)	Current Loan Balance	Amount of Monthly Payment	Date of Final Payment *(mmddyyyy)*	**Equity** FMV Minus Loan
18a Year	Make/Model		$	$	$		$
Mileage	License/Tag Number	Lender/Lessor Name, Address *(Street, City, State, ZIP code)*, and Phone Phone					
Vehicle Identification Number							
18b Year	Make/Model		$	$	$		$
Mileage	License/Tag Number	Lender/Lessor Name, Address *(Street, City, State, ZIP code)*, and Phone Phone					
Vehicle Identification Number							
18c Total Equity *(Add lines 18a, 18b and amounts from any attachments)*							$

PERSONAL ASSETS Include all furniture, personal effects, artwork, jewelry, collections *(coins, guns, etc.)*, antiques or other assets. Include intangible assets such as licenses, domain names, patents, copyrights, mining claims, etc.

	Purchase/ Lease Date *(mmddyyyy)*	Current Fair Market Value (FMV)	Current Loan Balance	Amount of Monthly Payment	Date of Final Payment *(mmddyyyy)*	**Equity** FMV Minus Loan
19a Property Description		$	$	$		$
Location *(Street, City, State, ZIP code)* and County	Lender/Lessor Name, Address *(Street, City, State, ZIP code)*, and Phone Phone					
19b Property Description		$	$	$		$
Location *(Street, City, State, ZIP code)* and County	Lender/Lessor Name, Address *(Street, City, State, ZIP code)*, and Phone Phone					
19c Total Equity *(Add lines 19a, 19b and amounts from any attachments)*						$

If you are self-employed, sections 6 and 7 must be completed before continuing.

Section 5: Monthly Income and Expenses

Monthly Income/Expense Statement *(For additional information, refer to Publication 1854.)*

Total Income		Total Living Expenses		IRS USE ONLY
Source	Gross Monthly	Expense Items [6]	Actual Monthly	Allowable Expenses
20 Wages (Taxpayer) [1]	$	35 Food, Clothing and Misc. [7]	$	
21 Wages (Spouse) [1]	$	36 Housing and Utilities [8]	$	
22 Interest - Dividends	$	37 Vehicle Ownership Costs [9]	$	
23 Net Business Income [2]	$	38 Vehicle Operating Costs [10]	$	
24 Net Rental Income [3]	$	39 Public Transportation [11]	$	
25 Distributions (K-1, IRA, etc.) [4]	$	40 Health Insurance	$	
26 Pension (Taxpayer)	$	41 Out of Pocket Health Care Costs [12]	$	
27 Pension (Spouse)	$	42 Court Ordered Payments	$	
28 Social Security (Taxpayer)	$	43 Child/Dependent Care	$	
29 Social Security (Spouse)	$	44 Life Insurance	$	
30 Child Support	$	45 Current year taxes (Income/FICA) [13]	$	
31 Alimony	$	46 Secured Debts (Attach list)	$	
Other Income (Specify below) [5]		47 Delinquent State or Local Taxes	$	
32	$	48 Other Expenses (Attach list)	$	
33	$	49 Total Living Expenses (add lines 35-48)	$	
34 Total Income (add lines 20-33)	$	50 Net difference (Line 34 minus 49)	$	

1 **Wages, salaries, pensions, and social security:** Enter gross monthly wages and/or salaries. Do not deduct tax withholding or allotments taken out of pay, such as insurance payments, credit union deductions, car payments, etc. To calculate the gross monthly wages and/or salaries:

If paid weekly - multiply weekly gross wages by 4.3. Example: $425.89 x 4.3 = $1,831.33

If paid biweekly (every 2 weeks) - multiply biweekly gross wages by 2.17. Example: $972.45 x 2.17 = $2,110.22

If paid semimonthly (twice each month) - multiply semimonthly gross wages by 2. Example: $856.23 x 2 = $1,712.46

2 **Net Income from Business:** Enter monthly net business income. This is the amount earned after ordinary and necessary monthly business expenses are paid. **This figure is the amount from page 6, line 89.** If the net business income is a loss, enter "0". Do not enter a negative number. If this amount is more or less than previous years, attach an explanation.

3 **Net Rental Income:** Enter monthly net rental income. This is the amount earned after ordinary and necessary monthly rental expenses are paid. Do not include deductions for depreciation or depletion. If the net rental income is a loss, enter "0." Do not enter a negative number.

4 **Distributions:** Enter the total distributions from partnerships and subchapter S corporations reported on Schedule K-1, and from limited liability companies reported on Form 1040, Schedule C, D or E. Enter total distributions from IRAs if not included under pension income.

5 **Other Income:** Include agricultural subsidies, unemployment compensation, gambling income, oil credits, rent subsidies, etc.

6 **Expenses not generally allowed:** We generally do not allow tuition for private schools, public or private college expenses, charitable contributions, voluntary retirement contributions or payments on unsecured debts. However, we may allow the expenses if proven that they are necessary for the health and welfare of the individual or family or the production of income. See Publication 1854 for exceptions.

7 **Food, Clothing and Miscellaneous:** Total of food, clothing, housekeeping supplies, and personal care products for one month. The miscellaneous allowance is for expenses incurred that are not included in any other allowable living expense items. Examples are credit card payments, bank fees and charges, reading material, and school supplies.

8 **Housing and Utilities:** For principal residence: Total of rent or mortgage payment. Add the average monthly expenses for the following: property taxes, homeowner's or renter's insurance, maintenance, dues, fees, and utilities. Utilities include gas, electricity, water, fuel, oil, other fuels, trash collection, telephone, cell phone, cable television and internet services.

9 **Vehicle Ownership Costs:** Total of monthly lease or purchase/loan payments.

10 **Vehicle Operating Costs:** Total of maintenance, repairs, insurance, fuel, registrations, licenses, inspections, parking, and tolls for one month.

11 **Public Transportation:** Total of monthly fares for mass transit *(e.g., bus, train, ferry, taxi, etc.)*

12 **Out of Pocket Health Care Costs:** Monthly total of medical services, prescription drugs and medical supplies *(e.g., eyeglasses, hearing aids, etc.)*

13 **Current Year Taxes:** Include state and Federal taxes withheld from salary or wages, or paid as estimated taxes.

Certification: *Under penalties of perjury, I declare that to the best of my knowledge and belief this statement of assets, liabilities, and other information is true, correct, and complete.*

Taxpayer's Signature	Spouse's signature	Date

After we review the completed Form 433-A, you may be asked to provide verification for the assets, encumbrances, income and expenses reported. Documentation may include previously filed income tax returns, pay statements, self-employment records, bank and investment statements, loan statements, bills or statements for recurring expenses, etc.

IRS USE ONLY *(Notes)*

Sections 6 and 7 must be completed only if you are SELF-EMPLOYED.

Section 6: Business Information

51 Is the business a sole proprietorship *(filing Schedule C)* ☐ **Yes**, Continue with Sections 6 and 7. ☐ **No**, Complete Form 433-B.
All other business entities, including limited liability companies, partnerships or corporations, must complete Form 433-B.

52 Business Name & Address *(if different than 1b)*

53 Employer Identification Number	54 Type of Business	55 Is the business a Federal Contractor ☐ **Yes** ☐ **No**
56 Business Website (web address)	57 Total Number of Employees	58 Average Gross Monthly Payroll
59 Frequency of Tax Deposits	60 Does the business engage in e-Commerce *(Internet sales)* If yes, complete *lines 61a and 61b* ☐ **Yes** ☐ **No**	

PAYMENT PROCESSOR *(e.g., PayPal, Authorize.net, Google Checkout, etc.)* Name & Address *(Street, City, State, ZIP code)*	Payment Processor Account Number
61a	
61b	

CREDIT CARDS ACCEPTED BY THE BUSINESS

Credit Card	Merchant Account Number	Issuing Bank Name & Address *(Street, City, State, ZIP code)*
62a		
62b		
62c		

63 **BUSINESS CASH ON HAND** Include cash that is not in a bank. **Total Cash on Hand** $

BUSINESS BANK ACCOUNTS Include checking accounts, online and mobile *(e.g., PayPal)* accounts, money market accounts, savings accounts, and stored value cards *(e.g., payroll cards, government benefit cards, etc.)*. Report Personal Accounts in Section 4.

Type of Account	Full name & Address *(Street, City, State, ZIP code)* of Bank,Savings & Loan, Credit Union or Financial Institution.	Account Number	**Account Balance** As of ________ *mmddyyyy*
64a			$
64b			$
64c **Total Cash in Banks** *(Add lines 64a, 64b and amounts from any attachments)*			$

ACCOUNTS/NOTES RECEIVABLE Include e-payment accounts receivable and factoring companies, and any bartering or online auction accounts. *(List all contracts separately, including contracts awarded, but not started.)* **Include Federal, state and local government grants and contracts.**

Accounts/Notes Receivable & Address *(Street, City, State, ZIP code)*	Status *(e.g., age, factored, other)*	Date Due *(mmddyyyy)*	Invoice Number or Government Grant or Contract Number	**Amount Due**
65a				$
65b				$
65c				$
65d				$
65e				$
65f **Total Outstanding Balance** *(Add lines 65a through 65e and amounts from any attachments)*				$

BUSINESS ASSETS Include all tools, books, machinery, equipment, inventory or other assets used in trade or business. Include a list and show the value of all intangible assets such as licenses, patents, domain names, copyrights, trademarks, mining claims, etc.

	Purchase/ Lease Date *(mmddyyyy)*	Current Fair Market Value (FMV)	Current Loan Balance	Amount of Monthly Payment	Date of Final Payment *(mmddyyyy)*	**Equity** FMV Minus Loan
66a Property Description		$	$	$		$
Location *(Street, City, State, ZIP code)* and Country		Lender/Lessor/Landlord Name, Address *(Street, City, State, ZIP code)*, and Phone Phone				
66b Property Description		$	$	$		$
Location *(Street, City, State, ZIP code)* and Country		Lender/Lessor/Landlord Name, Address *(Street, City, State, ZIP code)*, and Phone Phone				
66c Total Equity *(Add lines 66a, 66b and amounts from any attachments)*						$

Section 7 should be completed only if you are SELF-EMPLOYED

Section 7: Sole Proprietorship Information *(lines 67 through 87 should reconcile with business Profit and Loss Statement)*

Accounting Method Used: ☐ Cash ☐ Accrual

Use the prior 3, 6, 9 or 12 month period to determine your typical business income and expenses.

Income and Expenses during the period *(mmddyyyy)* *to (mmddyyyy)*

Provide a breakdown below of your average monthly income and expenses, based on the period of time used above.

Total Monthly Business Income		**Total Monthly Business Expenses** (Use attachments as needed)	
Source	Gross Monthly	Expense Items	Actual Monthly
67 Gross Receipts	$	**77** Materials Purchased [1]	$
68 Gross Rental Income	$	**78** Inventory Purchased [2]	$
69 Interest	$	**79** Gross Wages & Salaries	$
70 Dividends	$	**80** Rent	$
71 Cash Receipts not included in lines 67-70	$	**81** Supplies [3]	$
Other Income (Specify below)		**82** Utilities/Telephone [4]	$
72	$	**83** Vehicle Gasoline/Oil	$
73	$	**84** Repairs & Maintenance	$
74	$	**85** Insurance	$
75	$	**86** Current Taxes [5]	$
76 Total Income (Add lines 67 through 75)	$	**87** Other Expenses, including installment payments (Specify)	$
		88 Total Expenses (Add lines 77 through 87)	$
		89 Net Business Income (Line 76 minus 88) [6]	$

Enter the monthly net income amount from line 89 on line 23, section 5. If line 89 is a loss, enter "0" on line 23, section 5. Self-employed taxpayers must return to page 4 to sign the certification.

1 Materials Purchased: Materials are items directly related to the production of a product or service.

2 Inventory Purchased: Goods bought for resale.

3 Supplies: Supplies are items used in the business that are consumed or used up within one year. This could be the cost of books, office supplies, professional equipment, etc.

4 Utilities/Telephone: Utilities include gas, electricity, water, oil, other fuels, trash collection, telephone, cell phone and business internet.

5 Current Taxes: Real estate, excise, franchise, occupational, personal property, sales and employer's portion of employment taxes.

6 Net Business Income: Net profit from Form 1040, Schedule C may be used if duplicated deductions are eliminated (e.g., expenses for business use of home already included in housing and utility expenses on page 4). Deductions for depreciation and depletion on Schedule C are not cash expenses and must be added back to the net income figure. In addition, interest cannot be deducted if it is already included in any other installment payments allowed.

IRS USE ONLY *(Notes)*

At the end of the second full paragraph on page 599, replace the reference to Prop. Reg. § 301.6159-1(c) with Treas. Reg. § 301.6159-1(e)(2).

At the end of the third full paragraph on page 599, replace the reference to Prop. Reg. § 301.6159-1(e)(4) with Treas. Reg. § 301.6159-1(e)(5).

§ 15.03[B] (Partial Payment Installment Agreements)

At the end of the carryover paragraph on page 600, replace the reference to Prop. Reg. § 301.6159-1(a) with Treas. Reg. § 301.6159-1(i).

§ 15.04[A] (Offer in Compromise Application)

In March of 2009, the IRS separated the Offer in Compromise application, Form 656, from the instructions that were previously included in Form 656 itself. Form 656, which was revised further in May of 2012 and most recently in January of 2015, is now six pages. It is largely the same as the one included on pages 603–06 of the text but now includes a low-income certification section and a more detailed explanation of the terms and conditions associated with the offer. It also reflects an increased application fee of $186, effective for applications filed or or after January 1, 2014. *See* T.D. 9647, 2013-2 C.B. 816 (amending 26 C.F.R. § 300.3(b)(1)).

The worksheets, checklists, and other instructions that previously were included in Form 656 are now contained in Form 656-B, Offer in Compromise Booklet.

§ 15.04[B] (Processing the Application)

According to the IRS's own figures, out of approximately 57,000 offers in compromise received by the IRS in 2010, approximately 14,000 were accepted. *See* 2010 Data Book, Table 16, *available at* http://www.irs.gov/pub/irs-soi/10databk.pdf. More recent statistics reveal an increase in the acceptance rate for offers in compromise. According to a report from the National Taxpayer Advocate, the IRS accepted 26% more offers in March of 2012 compared to a year earlier. The number of offers accepted doubled when compared with the first two quarters of 2010. The report notes that, as of March 2012, the offer acceptance rate was 38 percent, among the highest in many years. National Taxpayer Advocate, *Fiscal Year 2013 Objectives Report to Congress*, *available at* http://www.taxpayeradvocate.irs.gov//userfiles/file/FY13ObjectivesReporttoCongress.pdf. IRS statistics for 2014 show 68,000 offers in compromise received and 27,000 accepted—an acceptance rate of nearly 40 percent. 2014 Data Book, Table 16, *available at* http://www.irs.gov/file_source/pub/irs-soi/14databk.pdf.

As noted in the text, a taxpayer whose offer is rejected by the IRS is entitled to request an appeal before the Appeals Division, independent of or in conjunction with a Collection Due

Process hearing. The IRS recently released amendments to the Internal Revenue Manual (as part of a larger Appeals Judicial Approach and Culture Project) that specify how Appeals agents should handle offer in compromise (OIC) appeals. Memorandum for Appeals Employees, Control No. AP-08-0713-03 (July 18, 2013), *available at* http://www.irs.gov/pub/foia/ig/spder/AP-08-0713-03.pdf. These amendments clarify that an OIC appeal is not an extension of the OIC processing activities that take place in the IRS Collection division. "The role and mission of Appeals are different than that of Collection." IRM 8.23.1.3(1). The Appeals officer's primary obligation is to "[d]etermine whether Collection was correct in rejecting the taxpayer's offer by addressing the disputed issues that caused the offer to be rejected." IRM 8.23.1(2). Officers are instructed not to re-work an offer rejected by Collections employees and not to conduct an investigation to identify new assets. Officers should consider only assets previously documented and to accept previously agreed-upon values. IRM 8.23.3.3(4). Furthermore, officers may only correct errors in determining the taxpayer's reasonable collection potential that are strictly computational in nature. IRM 8.23.3.3(3).

§ 15.04[C] (Offers Based on Doubt as to Collectibility)

At the same time that the IRS created Form 656-B, Offer in Compromise Booklet, it revised the Worksheet to Calculate an Offer Amount in order to make it consistent with previous revisions to Form 433-A, *Collection Information Statement for Wage Earners and Self-Employed Individuals*. In 2012, the IRS created a separate financial disclosure statement, Form 433-A(OIC), for taxpayers to use when applying for an offer in compromise, which was revised most recently in January of 2015. The worksheet included on pages 608–09 of the text should be replaced with the following:

Form **433-A (OIC)**
(Rev. January 2015)

Department of the Treasury — Internal Revenue Service

Collection Information Statement for Wage Earners and Self-Employed Individuals

Use this form if you are

- ► An individual who owes income tax on a Form 1040, U.S. Individual Income Tax Return
- ► An individual with a personal liability for Excise Tax
- ► An individual responsible for a Trust Fund Recovery Penalty
- ► An individual who is self-employed or has self-employment income. You are considered to be self-employed if you are in business for yourself, or carry on a trade or business.
- ► An individual who is personally responsible for a partnership liability (only if the partnership is submitting an offer)

Wage earners Complete Sections 1, 2, 3, 7, 8, 9 and the signature line in Section 10.
Self-employed individuals Complete Sections 4, 5, 6, in addition to Sections 1, 2 (if applicable), 3, 7, 8, 9 and the signature line in Section 10.
Note: Include attachments if additional space is needed to respond completely to any question.

Section 1 Personal and Household Information

Last Name	First Name	Date of Birth *(mm/dd/yyyy)*	Social Security Number - -
Marital status ☐ Unmarried ☐ Married	Home Address *(Street, City, State, ZIP Code)*	Do you: ☐ Own your home ☐ Rent ☐ Other *(specify e.g., share rent, live with relative, etc.)*	
County of Residence	Primary Phone ( ) -	Mailing Address *(if different from above or Post Office Box number)*	
Secondary Phone ( ) -	Fax Number ( ) -		

Provide information about your spouse.

Spouse's Last Name	Spouse's First Name	Date of Birth *(mm/dd/yyyy)*	Social Security Number - -

Provide information for all other persons in the household or claimed as a dependent.

Name	Age	Relationship	Claimed as a dependent on your Form 1040?	Contributes to household income?
			☐ Yes ☐ No	☐ Yes ☐ No
			☐ Yes ☐ No	☐ Yes ☐ No
			☐ Yes ☐ No	☐ Yes ☐ No
			☐ Yes ☐ No	☐ Yes ☐ No

Section 2 Employment Information for Wage Earners

If you or your spouse have self-employment income (that is you file a Schedule C, E, F, etc.) instead of, or in addition to wage income, you must complete Business Information in Sections 4, 5, and 6.

Your Employer's Name		Employer's Address *(street, city, state, zip code)*
Do you have an interest in this business? ☐ Yes ☐ No	If yes, check the business interest that applies: ☐ Partner ☐ Officer ☐ Sole proprietor	
Your Occupation	How long with this employer (years) (months)	
Spouse's Employer's Name		Employer's Address *(street, city, state, zip code)*
Does your spouse have an interest in this business? ☐ Yes ☐ No	If yes, check the business interest that applies: ☐ Partner ☐ Officer ☐ Sole proprietor	
Spouse's Occupation	How long with this employer (years) (months)	

Section 3 Personal Asset Information

Use the **most current** statement for each type of account, such as checking, savings, money market and online accounts, stored value cards *(such as, a payroll card from an employer)*, investment and retirement accounts *(IRAs, Keogh, 401(k) plans, stocks, bonds, mutual funds, certificates of deposit)*, life insurance policies that have a cash value, and safe deposit boxes. Asset value is subject to adjustment by IRS based on individual circumstances. Enter the total amount available for each of the following *(if additional space is needed include attachments)*.

Round to the nearest dollar. Do not enter a negative number. If any line item is a negative number, enter "0".

Cash and Investments (domestic and foreign)

☐ Cash ☐ Checking ☐ Savings ☐ Money Market/CD ☐ Online Account ☐ Stored Value Card		
Bank Name	Account Number	(1a) $
☐ Checking ☐ Savings ☐ Money Market/CD ☐ Online Account ☐ Stored Value Card		
Bank Name	Account Number	(1b) $
	Total of bank accounts from attachment	(1c) $
	Add lines (1a) through (1c) less ($1,000) =	**(1) $**
Investment Account: ☐ Stocks ☐ Bonds ☐ Other		
Name of Financial Institution	Account Number	
Current Market Value $ ______ X .8 = $ ______	Less Loan Balance – $ ______ =	(2a) $
Investment Account: ☐ Stocks ☐ Bonds ☐ Other		
Name of Financial Institution	Account Number	
Current Market Value $ ______ X .8 = $ ______	Less Loan Balance – $ ______ =	(2b) $
	Total of investment accounts from attachment. [current market value X.8 less loan balance(s)]	(2c) $
	Add lines (2a) through (2c) =	**(2) $**
Retirement Account: ☐ 401K ☐ IRA ☐ Other		
Name of Financial Institution	Account Number	
Current Market Value $ ______ X .7 = $ ______	Less Loan Balance – $ ______ =	(3a) $
Retirement Account: ☐ 401K ☐ IRA ☐ Other		
Name of Financial Institution	Account Number	
Current Market Value $ ______ X .7 = $ ______	Less Loan Balance – $ ______ =	(3b) $
	Total of investment accounts from attachment. [current market value X .7 less loan balance(s)]	(3c) $
	Add lines (3a) through (3c) =	**(3) $**
Cash Value of Life Insurance Policies		
Name of Insurance Company	Policy Number	
Current Cash Value $ ______	Less Loan Balance – $ ______ =	(4a) $
Total of life insurance policies from attachment $ ______	Less Loan Balance(s) – $ ______ =	(4b) $
	Add lines (4a) through (4b) =	**(4) $**

Section 3 *(Continued)* **Personal Asset Information**

Real Estate (Enter information about any house, condo, co-op, time share, etc. that you own or are buying)

Property Address *(Street Address, City, State, ZIP Code)*	Primary Residence ☐ Yes ☐ No	
	Date Purchased	
County and Country	Date of Final Payment	
How title is held *(joint tenancy, etc.)*	Description of Property	
Current Market Value $ ______ X .8 = $ ______	Less Loan Balance *(Mortgages, etc.)* – $ ______ (Total Value of Real Estate) =	(5a) $
Property Address *(Street Address, City, State, ZIP Code)*	Primary Residence ☐ Yes ☐ No	
	Date Purchased	
County and Country	Date of Final Payment	
How title is held *(joint tenancy, etc.)*	Description of Property	
Current Market Value $ ______ X .8 = $ ______	Less Loan Balance *(Mortgages, etc.)* – $ ______ (Total Value of Real Estate) =	(5b) $
Total value of property(s) from attachment [current market value X .8 less any loan balance(s)]		(5c) $
	Add lines (5a) through (5c) =	**(5) $**

Vehicles ***(Enter information about any cars, boats, motorcycles, etc. that you own or lease)***

Vehicle Make & Model		Year	Date Purchased	Mileage	
☐ Lease ☐ Loan	Name of Creditor		Date of Final Payment	Monthly Lease/Loan Amount $	
Current Market Value $ ______ X .8 = $ ______		Less Loan Balance *(Mortgages, etc.)* – $ ______		Total value of vehicle *(if the vehicle is leased, enter 0 as the total value)* =	(6a) $
				Subtract $3,450 from line (6a). If line (6a) less line (6b) is a negative number, enter "0".	(6b) $
Vehicle Make & Model		Year	Date Purchased	Mileage	
☐ Lease ☐ Loan	Name of Creditor		Date of Final Payment	Monthly Lease/Loan Amount $	
Current Market Value $ ______ X .8 = $ ______		Less Loan Balance *(Mortgages, etc.)* – $ ______		Total value of vehicle *(if the vehicle is leased, enter 0 as the total value)* =	(6c) $
				If you are filing a joint offer, subtract $3,450 from line (6c). If line (6c) less line (6d) is a negative number, enter "0".	(6d) $
Total value of vehicles listed from attachment [current market value X .8 less any loan balance(s)]					(6e) $
				Total lines (6a) through (6e) =	**(6) $**

Section 3 *(Continued)* Personal Asset Information

Other valuable items ***(artwork, collections, jewelry, items of value in safe deposit boxes, interest in a company or business that is not publicly traded, etc.)***

Description of asset:

Current Market Value $ ______ X .8 = $ ______ Less Loan Balance – $ ______ = (7a) $

Description of asset:

Current Market Value $ ______ X .8 = $ ______ Less Loan Balance – $ ______ = (7b) $

Total value of valuable items listed from attachment [current market value X .8 less any loan balance(s)] (7c) $

Add lines (7a) through (7c) = (7) $

Do not include amount on the lines with a letter beside the number. Round to the nearest whole dollar.
Do not enter a negative number. If any line item is a negative, enter "0" on that line.
Add lines (1) through (7) and enter the amount in Box A =

Box A
Available Individual Equity in Assets
$

NOTE: If you or your spouse are self-employed, Sections 4, 5, and 6 must be completed before continuing with Sections 7 and 8.

Section 4 Self-Employed Information

If you or your spouse are self-employed (e.g., files Schedule(s) C, E, F, etc.), complete this section.

Is your business a sole proprietorship?
☐ Yes ☐ No

Address of Business *(If other than personal residence)*

Name of Business

Business Telephone Number ( ) -	Employer Identification Number	Business Website		Trade Name or DBA
Description of Business	Total Number of Employees	Frequency of Tax Deposits	Average Gross Monthly Payroll $	

Do you or your spouse have any other business interests? Include any interest in an LLC, LLP, corporation, partnership, etc.
☐ Yes *(Percentage of ownership:)* Title:
☐ No

Business Address *(Street, City, State, ZIP code)*

Business Name	Business Telephone Number ( ) -	Employer Identification Number

Type of business *(Select one)*
☐ Partnership ☐ LLC ☐ Corporation ☐ Other ______

Section 5 Business Asset Information *(for Self-Employed)*

List business assets such as bank accounts, tools, books, machinery, equipment, business vehicles and real property that is owned/leased/rented. If additional space is needed, attach a list of items.

Round to the nearest whole dollar. Do not enter a negative number. If any line item is a negative number, enter "0".

☐ Cash ☐ Checking ☐ Savings ☐ Money Market/CD ☐ Online Account ☐ Stored Value Card
Bank Name | Account Number | (8a) $

☐ Cash ☐ Checking ☐ Savings ☐ Money Market/CD ☐ Online Account ☐ Stored Value Card
Bank Name | Account Number | (8b) $

Total value of bank accounts from attachment (8c) $

Add lines (8a) through (8c) = (8) $

Section 5 *(Continued)* **Business Asset Information** ***(for Self-Employed)***

Description of asset:	
Current Market Value $ ______ X .8 = $ ______ Less Loan Balance – $ ______ *(if leased or used in the production of income, enter 0 as the total value)* =	(9a) $
Description of asset:	
Current Market Value $ ______ X .8 = $ ______ Less Loan Balance – $ ______ *(if leased or used in the production of income, enter 0 as the total value)* =	(9b) $
Total value of assets listed from attachment [current market value X .8 less any loan balance(s)]	(9c) $
Add lines (9a) through (9c) =	**(9) $**
IRS allowed deduction for professional books and tools of trade –	(10) $ [4,540]
Enter the value of line (9) minus line (10). If less than zero enter zero. =	**(11) $**
Notes Receivable Do you have notes receivable? ☐ Yes ☐ No If yes, attach current listing which includes name and amount of note(s) receivable.	
Accounts Receivable Do you have accounts receivable, including e-payment, factoring companies, and any bartering or online auction accounts? ☐ Yes ☐ No If yes, you may be asked to provide a list of the account(s) receivable.	
Do not include amount on the lines with a letter beside the number. Round to the nearest whole dollar. Do not enter a negative number. If any line item is a negative, enter "0" on that line. **Add lines (8) and (11) and enter the amount in Box B =**	**Box B** Available Business Equity in Assets **$**

Section 6 Business Income and Expense Information ***(for Self-Employed)***

Note: If you provide a current profit and loss (P&L) statement for the information below, enter the total gross monthly income on line 17 and your monthly expenses on line 29 below. Do not complete lines (12) - (16) and (18) - (28). You may use the amounts claimed for income and expenses on your most recent Schedule C; however, if the amount has changed significantly within the past year, a current P&L should be submitted to substantiate the claim.

Round to the nearest whole dollar. Do not enter a negative number. If any line item is a negative number, enter "0".

Business Income ***(You may average 6-12 months income/receipts to determine your Gross monthly income/receipts.)***	
Gross receipts	(12) $
Gross rental income	(13) $
Interest income	(14) $
Dividends	(15) $
Other income	(16) $
Add lines (12) through (16) =	**(17) $**
Business Expenses ***(You may average 6-12 months expenses to determine your average expenses.)***	
Materials purchased *(e.g., items directly related to the production of a product or service)*	(18) $
Inventory purchased *(e.g., goods bought for resale)*	(19) $
Gross wages and salaries	(20) $
Rent	(21) $
Supplies *(items used to conduct business and used up within one year, e.g., books, office supplies, professional equipment, etc.)*	(22) $
Utilities/telephones	(23) $
Vehicle costs *(gas, oil, repairs, maintenance)*	(24) $
Business Insurance	(25) $
Current Business Taxes *(e.g., Real estate, excise, franchise, occupational, personal property, sales and employer's portion of employment taxes)*	(26) $
Other secured debts *(not credit cards)*	(27) $
Other business expenses *(include a list)*	(28) $
Add lines (18) through (28) =	**(29) $**
Round to the nearest whole dollar. Do not enter a negative number. If any line item is a negative, enter "0" on that line. **Subtract line (29) from line (17) and enter the amount in Box C =**	**Box C** Net Business Income **$**

Section 7 Monthly Household Income and Expense Information

Enter your household's gross monthly income. The information below is for yourself, your spouse, and anyone else who contributes to your household's income. The entire household includes spouse, significant other, children, and others who contribute to the household. This is necessary for the IRS to accurately evaluate your offer.

Monthly Household Income

Round to the nearest whole dollar.

Primary taxpayer Wages $ ______ + Social Security $ ______ + Pension(s) $ ______ + Other Income *(e.g. unemployment)* $ ______ Total primary taxpayer income =	(30) $
Spouse Wages $ ______ + Social Security $ ______ + Pension(s) $ ______ + Other Income *(e.g. unemployment)* $ ______ Total spouse income =	(31) $
Additional sources of income used to support the household, e.g., non-liable spouse, or anyone else who may contribute to the household income, etc.	(32) $
Interest and dividends	(33) $
Distributions *(e.g., income from partnerships, sub-S Corporations, etc.)*	(34) $
Net rental income	(35) $
Net business income from Box C	(36) $
Child support received	(37) $
Alimony received	(38) $
Round to the nearest whole dollar. Do not enter a negative number. If any line item is a negative, enter "0" on that line. **Add lines (30) through (38) and enter the amount in Box D =**	**Box D** Total Household Income $

Monthly Household Expenses

Enter your average monthly expenses.

Note: Expenses may be adjusted based on IRS Collection Financial Standards. The standards may be found at www.irs.gov.

Round to the nearest whole dollar.

Food, clothing, and miscellaneous *(e.g., housekeeping supplies, personal care products , minimum payment on credit card). A reasonable estimate of these expenses may be used.*	(39) $
Housing and utilities *(e.g., rent or mortgage payment and average monthly cost of property taxes, home insurance, maintenance, dues, fees and utilities including electricity, gas, other fuels, trash collection, water, cable television and internet, telephone, and cell phone).*	(40) $
Vehicle loan and/or lease payment(s)	(41) $
Vehicle operating costs *(e.g., average monthly cost of maintenance, repairs, insurance, fuel, registrations, licenses, inspections, parking, tolls, etc.)*. A reasonable estimate of these expenses may be used.	(42) $
Public transportation costs *(e.g., average monthly cost of fares for mass transit such as bus, train, ferry, taxi, etc.). A reasonable estimate of these expenses may be used.*	(43) $
Health insurance premiums	(44) $
Out-of-pocket health care costs *(e.g. average monthly cost of prescription drugs, medical services, and medical supplies like eyeglasses, hearing aids, etc.)*	(45) $
Court-ordered payments *(e.g., monthly cost of any alimony, child support, etc.)*	(46) $
Child/dependent care payments *(e.g., daycare, etc.)*	(47) $
Life insurance premiums	(48) $
Current taxes *(e.g., monthly cost of federal, state, and local tax, personal property tax, etc.)*	(49) $

Section 7 — Monthly Household Income and Expense Information *(Continued)*

Other secured debts *(e.g., any loan where you pledged an asset as collateral not previously listed, government guaranteed Student Loan)*	(50) $
Delinquent State and Local Taxes	(51) $
Round to the nearest whole dollar. Do not enter a negative number. If any line item is a negative, enter "0" on that line. **Add lines (39) through (51) and enter the amount in Box E =**	**Box E** Total Household Expenses $
Round to the nearest whole dollar. Do not enter a negative number. If any line item is a negative, enter "0" on that line. **Subtract Box E from Box D and enter the amount in Box F =**	**Box F** Remaining Monthly Income $

Section 8 — Calculate Your Minimum Offer Amount

The next steps calculate your minimum offer amount. The amount of time you take to pay your offer in full will affect your minimum offer amount. Paying over a shorter period of time will result in a smaller minimum offer amount.

Round to the nearest whole dollar.

If you will pay your offer in 5 months or less, multiply "Remaining Monthly Income" *(Box F)* by 12 to get "Future Remaining Income" *(Box G)*. Do not enter a number less than $0.

Enter the total from Box F		Box G Future Remaining Income
$	**X 12 =**	$

If you will pay your offer in more than 5 months, multiply "Remaining Monthly Income" (Box F) by 24 to get "Future Remaining Income" (Box H). Do not enter a number less than $0.

Enter the total from Box F		Box H Future Remaining Income
$	**X 24 =**	$

Determine your minimum offer amount by adding the total available assets from Box A and Box B (if applicable) to the amount in either Box G or Box H.

Enter the amount from Box A plus Box B (if applicable)		Enter the amount from either Box G or Box H		**Offer Amount** **Your offer must be more than zero ($0). Do not leave blank. Use whole dollars only.**
$	+	$	=	$

If you cannot pay the Offer Amount shown above due to special circumstances, explain on the Form 656, Offer in Compromise, Section 3. You must offer an amount more than $0.

Section 9 — Other Information

Additional information IRS needs to consider settlement of your tax debt. If you or your business are currently in a bankruptcy proceeding, you are not eligible to apply for an offer.	Are you the beneficiary of a trust, estate, or life insurance policy? ☐ Yes ☐ No	
	Are you currently in bankruptcy? ☐ Yes ☐ No	Have you filed bankruptcy in the past 10 years? ☐ Yes ☐ No
	Discharge/Dismissal Date *(mm/dd/yyyy)*	Location Filed
	Are you or have you been party to a lawsuit? ☐ Yes ☐ No If yes, date the lawsuit was resolved: *(mm/dd/yyyy)*	
	In the past 10 years, have you transferred any assets for less than their full value? ☐ Yes ☐ No If yes, date the asset was transferred: *(mm/dd/yyyy)*	
	Have you lived outside the U.S. for 6 months or longer in the past 10 years? ☐ Yes ☐ No	
	Do you have any funds being held in trust by a third party? ☐ Yes ☐ No If yes, how much $ Where:	

Section 10	Signatures

Under penalties of perjury, I declare that I have examined this offer, including accompanying documents, and to the best of my knowledge it is true, correct, and complete.

Signature of Taxpayer	Date *(mm/dd/yyyy)*
Signature of Taxpayer	Date *(mm/dd/yyyy)*

Remember to include all applicable attachments listed below.

- ☐ Copies of the most recent pay stub, earnings statement, etc., from each employer
- ☐ Copies of the most recent statement for each investment and retirement account
- ☐ Copies of the most recent statement, etc., from all other sources of income such as pensions, Social Security, rental income, interest and dividends (including any received from a related partnership, corporation, LLC, LLP, etc.), court order for child support, alimony, and rent subsidies
- ☐ Copies of bank statements for the three most recent months
- ☐ Copies of the most recent statement from lender(s) on loans such as mortgages, second mortgages, vehicles, etc., showing monthly payments, loan payoffs, and balances
- ☐ List of Notes Receivable, if applicable
- ☐ Verification of State/Local Tax Liability, if applicable
- ☐ Documentation to support any special circumstances described in the "Explanation of Circumstances" on Form 656, if applicable
- ☐ Attach a Form 2848, *Power of Attorney*, if you would like your attorney, CPA, or enrolled agent to represent you and you do not have a current form on file with the IRS.

In 2012, the IRS announced temporary changes to the OIC program that could allow taxpayers to qualify more easily for an offer based on doubt as to collectibility. In an information release, the IRS announced that it would start looking at one year of future income (rather than four) for offers paid in five or fewer months and two years of future income (rather than five) for offers paid in six to 24 months. *See* I.R.S. News Release IR-2012-53 (May 21, 2012), *available at* http://www.irs.gov/uac/IRS-Announces-More-Flexible-Offer-in-Compromise-Terms-to-Help-a-Greater-Number-of-Struggling-Taxpayers-Make-a-Fresh-Start. The memorandum also allows minimum payments on certain student loans for post-high school education to be taken into account when calculating the taxpayer's ability to pay his or her federal tax liability. *Id.* These changes have also been incorporated into the OIC application. *See* Form 433-A(OIC), Secs. 7–8, *available at* http://www.irs.gov/pub/irs-pdf/f433aoi.pdf.

Dissipated assets may prevent a taxpayer from qualifying for a compromise. In *Tucker v. Commissioner*, T.C. Memo. 2011-67, 2011 Tax Ct. Memo LEXIS 65, *aff'd* 676 F.3d 1129 (D.C. Cir. 2012), the Tax Court upheld the Appeals Officer's decision in a CDP case to reject the taxpayer's request for an offer in compromise. When calculating the taxpayer's reasonable collection potential for purposes of determining whether the taxpayer could pay his outstanding $39,000 tax debt in full, the Appeals Officer took into account as dissipated assets funds the taxpayer transferred to an online brokerage account and lost while day trading. *Id.* at *24–26. The Tax Court ruled that, because the taxpayer was aware of his unpaid tax liability when he transferred the funds to the account, he lost the money in disregard of his outstanding tax debt. Taking the dissipated assets into account, the court found that the taxpayer's reasonable collection potential exceeded his outstanding liability, thus the Appeals Officer did not err when he rejected the taxpayer's offer in compromise. *Id.* at *43–44. However, in the same News Release discussed above, the IRS narrowed the circumstances under which it takes dissipated assets into account in determining the net realizable value of the taxpayer's assets. According to the revised guidance, equity in income-producing assets will not be added to the reasonable collection potential of a viable, ongoing business unless it is determined the assets are not critical to business operations. I.R.S. News Release IR-2012-53, *supra*. *See also* IRM 5.8.5.5.1.

§ 15.05 (THE BANKRUPTCY OPTION)

For helpful discussions of bankruptcy possibilties in tax cases, see Robert Gard, *Basic Bankruptcy Treatment of Income Tax for Individuals*, 42 TAX ADVISER 480 (2011); Arlene Hibschweiler & Martha Salzman, *Chapter 13: Tax Considerations*, 44 TAX ADVISER 302 (2013); Martha L. Saltzman & Arlene M. Hibschweiler, *Timing Considerations of Discharging Taxes in a Chapter 7 Bankruptcy*, 43 TAX ADVISER 104 (2012); Frances Sheehy, *The Impact of Bankruptcy on Tax Debts*, J. TAX PRAC. & PROC., Feb.-Mar. 2014, at 31.

Chapter 16

§ 16.01 (Introduction)

Data reported by the National Taxpayer Advocate (NTA) reveal that few taxpayers take advantage of their Collection Due Process (CDP) rights. According to the NTA's 2013 Annual Report, "in FY 2012, the IRS issued over 3.6 million CDP notices and received only about 47,500 CDP hearing requests, approximately 1.31 percent of hearings offered." National Taxpayer Advocate, *2013 Annual Report to Congress*, 56, *available at* http://www.taxpayeradvocate.irs.gov/2013-Annual-Report/full-2013-annual-report-to-congress.html.

§ 16.02[A] (Requesting a CDP Hearing)

In 2013, the IRS revised the form taxpayers use to request a CDP hearing. *See* Form 12153, *Request for a Collection Due Process or Equivalent Hearing*, *available at* http://www.irs.gov/pub/irs-pdf/f12153.pdf. The form reflects updated procedures and changes to financial disclosure statements.

A series of recent Technical Advice Memoranda from the IRS Chief Counsel's Office clarify rules for submitting CDP hearing requests. The issue in Memorandum 2012-29 was whether a "misaddressed Collection Due Process (CDP) hearing request [is] timely if it is received in the service center mailroom prior to the due date for requesting a hearing but it does not reach the office responsible for processing the request until after the due date[.]" CCM 2012-29 (Dec. 7. 2012), *available at* http://www.irs.gov/pub/lanoa/pmta_2012-29.pdf. The memo explains that, when the IRS directs that a document be filed by mailing it to a post office box designated for ultimate delivery within a service center, the document is deemed filed when the U.S. postal service delivers the document to the service center. According to the memo, the postal service cannot deliver it to a particular location within the center. As a result, "[i]t would be unreasonable to require, for the purpose of determining timeliness of the filing of a CDP hearing request, delivery to an office the Postal Service is not able to reach." *Id.*

A separate memo, CCM 2013-11, answers the following question in the negative: "If a taxpayer sends a [CDP] hearing request to an incorrect IRS office, and that office receives the request before the statutory deadline but incorrectly forwards it directly to Appeals, which results in the correct collection office receiving the request after the statutory deadline, has the taxpayer made a timely hearing request?" CCM 2013-11 (June 7, 2013), *available at* http://www.irs.gov/pub/lanoa/pmta_2013-11.pdf. The memo explains that, because the taxpayer did not submit the notice to the correct address, the mailbox rule in section 7502 does not apply. As a result, the hearing request must arrive at the correct collection office by its due date to be considered timely. While the Internal Revenue Manual directs offices that receive misaddressed requests to send them to the appropriate recipient, this does not always take place. Notwithstanding the Internal Revenue Manual policy, the memorandum concludes that a taxpayer's failure to file a required document at a particular location will cause the case to be dismissed. Furthermore, the taxpayer would have no grounds for asserting estoppel against the IRS as long as the IRS's failure to forward the document to the correct office did not include affirmative misconduct. The taxpayer may, however, be offered an equivalent hearing. *Id.*

§ 16.02[C] (Conducting a CDP Hearing)

Section e. of the excerpt from the Collection Due Process Handbook, starting on page 632, includes a reference to the Tax Court's decision in *Cox v. Commissioner*, 126 T.C. 237 (2006). In *Cox*, the Tax Court held that an Appeals Officer who reviewed a taxpayer's 2001 and 2002 tax liabilities as part of a CDP hearing involving the taxpayer's 2000 liability was not prohibited from later conducting a CDP hearing relating to the 2001 and 2002 tax years. *Id.* at 252–53. According to the Tax Court, the Appeals Officer's prior involvement did not run afoul of the restriction in section 6330(b). *Id.* In 2009, the Court of Appeals for the Tenth Circuit reversed the Tax Court, finding that the CDP hearing for tax year 2000 addressed the 2001 and 2002 tax years and the officer's participation thereby violated the prohibition against "prior involvement" by the same Appeals Officer. Cox v. Commissioner, 514 F.3d 1119 (10th Cir. 2008). In so doing, the Tenth Circuit invalidated Treasury regulation section 301.6330-1(d)(2), which excludes prior CDP hearings from the definition of "prior involvement." *See id.* at 1125–27.

The Chief Counsel's Office issued an Action on Decision, AOD 2009-22, I.R.B. 2009-22, 2009 AOD LEXIS 1 (June 1, 2009), in which it recommended nonacquiescence in the Tenth Circuit's opinion.

> The appellate court incorrectly concluded that the term "involvement" has a plain meaning. That term is not defined in the statute or in legislative history and is an inherently ambiguous term. In failing to give proper deference to the agency's construction of "involvement" in the 2002 regulations, the appellate court consequently erred.
>
> An appeals officer is not legally precluded under the "no prior involvement" language found in section 6330(b)(3) from conducting a taxpayer's CDP hearing for a given tax year because he considered the taxpayer's compliance history when evaluating the taxpayer's eligibility for collection alternatives during a prior CDP hearing. Consistent with the construction of "prior involvement" reflected in the regulation, no disqualifying involvement arises when the same appeals officer holds consecutive CDP hearings for the same taxpayer who has accrued new, unpaid tax liabilities. Prior involvement refers, instead, to an appeals officer having considered the tax year at issue in a prior non-CDP context, such as when the appeals officer worked on the collection of the tax as a revenue officer.

> Although we disagree with the opinion, we recognize the precedential effect of the decision on cases appealable to the Tenth Circuit, and therefore will adhere to it in cases within that circuit that cannot be meaningfully distinguished. We do not, however, acquiesce in the opinion and will continue to litigate our position in all other circuits.

Id. at *2–4.

The IRS recently released amendments to the Internal Revenue Manual as part of a larger Appeals Judicial Approach and Culture Project that specify how Appeals agents should handle Collection Due Process cases. Memorandum for Appeals Employees, Control No. AP-08-0713-03 (July 18, 2013) (amending IRM section 8.22.4.2.1). The amendments clarify that the Appeals officer's function in a CDP case is to make a determination based on the facts and the law known during the time of the CDP hearing. IRM 8.22.4.2.1(1). If the file sent to the Appeals officer is incomplete, it cannot simply be returned to the Collection division. Instead, the Appeals officer must decide whether to request the relevant information from the taxpayer or submit a formal referral to the Collection division to secure and verify the information. Alternatively, the Appeal officer can decide to make a determination based on the information already in the file. IRM 8.22.4.2.1(3).

§ 16.02[D][1] (Scope of CDP Hearing — In General)

A recent Tax Court decision clarifies a taxpayer's appeal rights when the Appeals officer returns—but does not reject—the taxpayer's offer in compromise (OIC) request as part of a CDP hearing. In *Reed v. Commissioner*, 141 T.C. 248 (2013), the taxpayer submitted in 2004 an OIC request based on doubt as to collectibility that was rejected because the taxpayer had dissipated his assets. *Id.* at 251. In 2008, he submitted a second OIC request based on doubt as to collectibility, which was returned as unprocessible because he failed to submit the necessary information. *Id.* Nonetheless, the taxpayer made payments consistent with the 2008 offer request. *Id.* In 2011, as part of a pre-levy CDP hearing, the IRS Appeals officer upheld the levy and rejected the taxpayer's request to reopen the 2008 offer. *Id.* The Tax Court sustained the officer's determination under an abuse of discretion standard:

> We now address whether the Commissioner can be required to reopen an OIC based on doubt as to collectibility that he returned to a taxpayer years before a collection hearing commenced. Petitioner urges us to adopt the theory that respondent can be required to do so. *See* sec. 6330(c)(2)(A)(iii). We decline to adopt petitioner's theory for two reasons.
>
> First, adopting the theory petitioner advances would impermissibly expand the Commissioner's authority to compromise an unpaid tax liability. The Commissioner must evaluate an OIC proposed during a collection hearing according to his authority to compromise an unpaid tax liability. *See* secs. 6330,

> 7122; Johnson v. Commissioner, 136 T.C. 475, 484-485 (2011), *aff'd*, 502 Fed. Appx. 1 (D.C. Cir. 2013). Here, petitioner requested in 2011 that respondent consider the 2008 offer based on doubt as to collectibility. Taxpayers must submit current financial data when proposing an OIC based on doubt as to collectibility. *See* Sullivan v. Commissioner, T.C. Memo. 2009-4; Godwin v. Commissioner, T.C. Memo. 2003-289. The theory petitioner advances would impermissibly expand the Commissioner's authority by allowing the Commissioner to evaluate an OIC based on doubt as to collectibility using a taxpayer's past financial circumstances. *See* sec. 7122(d)(1);. . .
>
> Presently, for example, petitioner's theory would have allowed petitioner to effectively propose an OIC based on doubt as to collectibility in 2011 using his financial data from 2008. Respondent, in turn, would be forced to evaluate the OIC based on doubt as to collectibility using financial data that only by mere chance reflects petitioner's then-current financial circumstances.
>
> And second, adopting the theory petitioner advances would substantially interfere with the statutory scheme Congress created. Taxpayers may currently seek administrative review of the Commissioner's rejecting an OIC. Sec. 7122(e). Taxpayers currently have no right, however, to seek review of the Commissioner's returning an OIC. Sec. 301.7122-1(f)(5)(ii), Proced. & Admin. Regs. The theory petitioner advances would, in effect, create additional layers of administrative and judicial review of the Commissioner's returning an OIC before a collection hearing commences. *See* sec. 6330(d). Petitioner's theory would not create analogous layers of review, however, for the Commissioner's returning an OIC after a collection hearing concludes. *See id.* Whether a taxpayer may access these new layers of review would therefore depend on when the Commissioner returns an OIC. Petitioner offers no, and we can find no, reasonable explanation for such disparate treatment based only on when the Commissioner returns an OIC.

Id. at 254–56.

§ 16.03[A][1] (Which Court Has Jurisdiction Over a CDP Appeal?)

Now that the U.S. Tax Court hears all appeals from CDP determinations, what are the limits on its jurisdiction? In two fairly recent cases, the Tax Court held that it has jurisdiction under the amended version of section 6330(d), regardless of the type of tax involved.

First, in *Callahan v. Commissioner*, 130 T.C. 44 (2008), the taxpayers were assessed a frivolous return penalty (discussed in Section 3.02[A] of the text) after filing a refund claim seeking "'Every penny you collected from us, plus interest' for 2003." *Id.* at 45. Following a CDP hearing in which they were denied relief, the taxpayers petitioned the Tax Court. *Id.* at 46.

The Tax Court held that it had jurisdiction to hear the appeal, under the revised statute. It noted, in part:

> The Staff of the Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 109th Congress (JCS-1-07), at 507 (J. Comm. Print 2007), explains the amendment to section 6330(d)(1): "The provision modifies the jurisdiction of the Tax Court by providing that all appeals of collection due process determinations are to be made to the United States Tax Court."

Id. at 48.

In *Michael v. Commissioner*, 133 T.C. 237 (2009), the Tax Court held that it had jurisdiction to review the IRS's levy of unpaid return preparer penalties (discussed in Section 12.03 of the text) despite settlement of a prior refund action. In that case, after the IRS assessed return preparer penalties against Mr. Michael, he paid the required portion of the penalties and then filed a refund suit. *Id.* at 238–39. He settled the case with the IRS, and the suit was dismissed with prejudice. *Id.* at 239. When he failed to pay the agreed amount, the IRS issued Notices of Intent to Levy in the amount of the original assessments. Mr. Michael requested and received a CDP hearing that reduced the assessment to the amounts agreed to in the settlement agreement. *Id.* at 239–40. However, he contested the IRS's right to collect those amounts by levy. *Id.* at 242. Among other things, he argued that the Tax Court lacked jurisdiction over the case. On this issue, the court held:

> Section 6330(d) grants this Court exclusive jurisdiction to review appeals from all section 6330 determinations made after October 16, 2006, irrespective of the type of tax making up the underlying tax liability. Sec. 6330(d)(1); Pension Protection Act of 2006, Pub. L. 109-280, sec. 855, 120 Stat. 1019; see *Ginsberg v. Commissioner*, 130 T.C. 88, 92 (2008). In a levy action under section 6330, the Court's jurisdiction depends on the issuance of a notice of determination and the taxpayer's timely filing of a petition. See *Sarrell v. Commissioner*, 117 T.C. 122, 125 (2001); *Moorhous v. Commissioner*, 116 T.C. 263, 269 (2001). The Government's counterclaim in the refund suit does not preclude the Court's having jurisdiction to review section 6330 determinations.

Id.

§ 16.03[B] (Judicial Review of Administrative CDP Determinations)

Can the Tax Court remand a CDP matter to the IRS to consider a taxpayer's changed circumstances? In *Churchill v. Commissioner*, T.C. Memo. 2011-182, 2011 Tax Ct. Memo LEXIS 181, the Tax Court held that it could remand the case to Appeals because the taxpayer had gotten divorced since his CDP hearing. The court explained, "It's not sensible for us to hold that the Appeals Office has abused its discretion in failing to consider information that it didn't have any way of knowing about," *id.* at *15, and concluded, "[w]e therefore hold that we do have authority to remand a CDP case for consideration of changed circumstances when remand would be helpful, necessary, or productive. This standard is satisfied in this case. This means that the answer to the question with which we began—did the Commissioner abuse his discretion in declining Churchill's offer in compromise—is that we can't say yet," id. at *16. For a discussion of Churchill and other cases in which the Tax Court has construed its CDP jurisdiction expansively, see Carlton M. Smith, *The Tax Court Keeps Growing Its Collection Due Process Powers*, 133 TAX NOTES 859 (2011).

A more recent case with somewhat different facts contrasts with *Churchill*. In *Kehoe v. Commissioner*, T.C. Memo. 2013-63, 2013 Tax Ct. Memo LEXIS 77 at *15, the court acknowledged its "authority to remand a CDP case for consideration of changed circumstances when remand would be helpful, necessary, or productive." However, the court found that despite the fact that "[s]ince petitioners' CDP hearing, Mr. Kehoe has become eligible to make withdrawals from his IRA without the threat of penalty[,] . . . it does not reflect a change that would have potentially affected respondent's decision to proceed with the filing of the NFTL. Consequently, the facts presented do not show a material change in circumstances such that remand would be appropriate." *Id.* at *16.

For a case distinguishing the facts of *Kehoe* and coming to a different conclusion, see *Budish v. Commissioner*, T.C. Memo. 2014-239, 2014 Tax Ct. Memo LEXIS 237 ("[In *Kehoe*,] the Appeals officer duly considered the taxpayer's contentions and . . . on balance, reasonably determined that the lien was necessary to protect the Government's interests . . . In this case, petitioner presented evidence of potential financial hardship, which the Appeals officer does not appear to have rejected as unsubstantiated but, nonetheless, did reject simply because she apparently felt she had no other choice under the IRM.").

Some scholars have suggested that delays at the IRS Office of Appeals burden taxpayers in CDP cases. *See, e.g.*, Carlton M. Smith & T. Keith Fogg, *Collection Due Process Hearings Should Be Expedited*, 2009 TAX NOTES TODAY 225-8 (Nov. 25, 2009). In their study of "both regular and CDP dockets arising from petitions filed in the Tax Court in the first six weeks of 2008," Smith and Fogg found that, on average, CDP cases take about one-third longer to resolve than non-CPD cases. Carlton M. Smith & T. Keith Fogg, *Tax Court Collection Due Process Cases Take Too Long*, 130 TAX NOTES 403 (2011). The authors called for changes that would expedite the process through which the IRS and the Tax Court handle CDP cases. *Id.* at 417.

For an argument that "an APA explanation requirement should be applied to CDP determinations involving collection— as opposed to liability—determinations," see Steve R. Johnson, *Reasoned Explanation and IRS Adjudication*, 63 DUKE L.J. 1771, 1777 (2014).

§ 16.03[B][1] (Standard of Review)

In *Pohl v. Commissioner*, T.C. Memo. 2013-291, 2013 Tax Ct. Memo LEXIS 300, the Tax Court explained the law on the standard of review it applies to CDP cases as follows:

> Section 6330(d)(1) does not prescribe the standard of review that this Court shall apply in reviewing an IRS administrative determination in a CDP case. The general parameters for such review are marked out by our precedents. Where the validity of the underlying tax liability is at issue, the Court will review the Commissioner's determination de novo. *Goza v. Commissioner*, 114 T.C. 176, 181–182 (2000). Where there is no dispute concerning the underlying tax liability, the Court reviews the IRS decision for abuse of discretion. *Id.* at 182.

Id. at *7.

Thus the Tax Court's position is that *de novo* review is the correct standard in a subset of CDP cases. The IRS disagrees. *See* Chief Counsel Notice 2014-002, *available at* http://www.irs.gov/pub/irs-ccdm/cc%202014%20002.pdf. In the Notice, the IRS explained:

> This notice alerts Chief Counsel attorneys to the Internal Revenue Service's long-standing position that a determination by the IRS Office of Appeals in a Collection Due Process (CDP) case that the Service has complied with all applicable legal and administrative procedural requirements, including any statutes of limitations, is subject to review by the Tax Court only for abuse of discretion. Chief Counsel attorneys should also take the position that abuse of discretion is the proper standard of review for a determination by Appeals about payments and overpayment credits and their proper application.

Id.

In a 2012 appeal from the Tax Court, the Court of Appeals for the First Circuit considered whether *de novo* review was appropriate in a CDP case on the question of whether the taxpayers owned certain property. *See* Dalton v. Commissioner, 682 F.3d 149, 154 (1st Cir. 2012). Reversing the Tax Court, the First Circuit held that abuse of discretion is the appropriate standard. *Id.* It stated: "[A] court's role in the CDP process is simply to confirm that the IRS did not abuse its wide discretion and—as part and parcel of that inquiry—to ensure that the agency's subsidiary factual and legal determinations were reasonable." *Id.* Furthermore, the First Circuit found that the standard of review is the same regardless of whether a court is reviewing a question of fact, a question of law, or a mixed question of law and fact. *Id.* at 159. In *Dalton*, the First Circuit concluded that the IRS did not abuse its discretion when rejecting the taxpayer's offer in compromise. *Id.* at 159–60.

For an analysis of *Dalton* and related cases, see William E. Taggart, Jr., *The* Dalton

Cases—Be Careful What You Ask For—You May Get It!, J. TAX PRAC. & PROC., Oct.-Nov. 2012, at 19, 19 (stating that *Dalton* "casts a shadow over every decision made by the Tax Court in a CDP case."). *See also* Adam M. Cole, Note, *A Preference for Deference: The Benefits of the First Circuit's Customized Standard of Review for Collection Due Process Appeals in* Dalton v. Commissioner, 58 VILL. L. REV. 239, 266 (2013) (arguing that "the *Dalton* standard properly protects taxpayers from IRS abuse because it catches egregious agency errors while allowing the IRS to carry out its collection function without unnecessary intrusion."). Chief Counsel Notice 2014-002, discussed at the beginning of this Section, does not cite or discuss *Dalton*.

§ 16.03[B][2] (Should Judicial Review be Limited to the Administrative Record?)

For recent analysis of the "record rule," including discussion of a proposed amendment to Code section 7482 that would clarify that Tax Court innocent spouse and CDP decisions "'follow the generally applicable rule for appellate review,'" see Marie Sapirie, *Revisiting the Record Rule in CDP Cases*, 146 TAX NOTES 1044, 1044 (2015). For an argument against a strong "record review" rule, see Bryan T. Camp, *The Failure of Adversarial Process in the Administrative State*, 84 IND. L.J. 57, 89–102 (2009). For a response, see Leslie Book, *A Response to Professor Camp: The Importance of Oversight*, 84 IND. L.J. SUPP. 63 (2009). For an argument in favor of record review, see Danshera Cords, *Administrative Law and Judicial Review of Tax Collection Decisions*, 52 ST. LOUIS U. L.J. 429 (2008); *cf.* Diane L. Fahey, *Is the United States Tax Court Exempt from Administrative Law Jurisprudence when Acting as a Reviewing Court?*, 58 CLEV. ST. L. REV. 603, 647–48 (2010) (arguing that, "[b]y adhering to traditional administrative law jurisprudence and the strictures of the APA, the Tax Court would be acting in accordance with the values this body of law is designed to implement: uniformity in procedure.").

§ 16.03[C] (Tax Court Jurisdiction and Remedies)

In *Thornberry v. Commissioner*, 136 T.C. 356, 364 (2011), the Tax Court held that boilerplate letters entitled "Appeals is disregarding your request for a Collection Due Process and/or Equivalent Hearing," rather than "Notice of Determination" were sufficient to give the Tax Court jurisdiction to review the IRS's decision to deny the hearing request. That case involved taxpayers who used "a prechecked laundry list of items they obtained from the Web site of an organization known to promote frivolous arguments and activities that delay or impede the administration of Federal tax laws." *Id.* at 369. The Tax Court explained that "Because no notice of deficiency was sent with respect to the section 6702 penalty, Mr. Thornberry was entitled to contest the assessed penalty at a hearing." *Id.* at 371. The court also noted:

> The determination letters do not specifically identify any statement in petitioners' requests or any paragraph in the attachment that reflects a desire to delay or impede Federal tax administration. The determination letters do not explain the basis upon which the Appeals Office determined that petitioners' requests reflect a desire to delay or

> impede Federal tax administration. We think that it was improper for the Appeals Office to treat those portions of petitioners' requests that set forth issues identified as legitimate in the determination letters as if they were never submitted without explaining how the requests reflect a desire to delay or impede Federal tax administration.

Id. Accordingly, the court denied the IRS's motion to dismiss but "require[d] petitioners to identify the specific issues and the grounds they wish to raise before taking further action in this case." *Id.* at 373.

The IRS responded to *Thornberry* with Chief Counsel Notice CC-2012-003, in which it stated, "(1) a taxpayer is not entitled to a CDP hearing when the entire hearing request meets the requirements of clause (i) or (ii) of section 6702(b)(2)(A) [involving a "specified frivolous submission"], and (2) contrary to the Tax Court's holding in *Thornberry*, the court does not have jurisdiction to review Appeals' determination that the taxpayer is not entitled to a CDP hearing." CC-2012-003, 2011 CCN LEXIS 19, at *3 (2012). The Notice reasoned:

> The holding in *Thornberry* that the Tax Court may review Appeals' overall determination that the request was frivolous, without contradicting the bar on judicial review of the portions of the request that Appeals disregarded, is incorrect. A review of Appeals' hearing rejection will never differ in effect or substance from a review of the frivolous portions of the hearing request. The court's reasoning renders the bar on judicial review meaningless, as is borne out by the opinion in *Thornberry*, in which the court reviewed in detail the portions of the hearing request at issue. The court's review of Appeals' hearing rejection is indistinguishable from a review of the hearing request itself, and nullifies the judicial bar of section 6330(g).
>
> Further, the holding in *Thornberry* that the Tax Court has jurisdiction to review a denial of hearing under section 6330(g) is incorrect. Because there is no determination subject to judicial review, a motion to dismiss for lack of jurisdiction should be filed if the taxpayer petitions from a section 6330(g) denial. If it is determined in the course of preparing the motion to dismiss that the hearing request states any non-frivolous grounds for a hearing and so should not have been disregarded in its entirety, the motion to dismiss should state that Counsel has instructed Appeals to provide a hearing based on the non-frivolous portion of the taxpayer's hearing request and that Appeals will thereafter issue a Notice of Determination that will be subject to judicial review.

Id. at *11–12 (footnote omitted).

For a case that reinforces the holding in *Thornberry*, despite distinguishing it on the facts, see *Buczek v. Commissioner*, 143 T.C. No. 16 (2014), 2014 U.S. Tax Ct. LEXIS 48 *13 ("[T]he decision entered in *Thornberry* demonstrates the importance of this Court's review of the

Appeals Office's determinations under section 6330(g) in protecting taxpayers from determinations that are arbitrary and capricious. Our Opinion today demonstrates that our review does not violate or eviscerate section 6330(g), and we therefore decline respondent's invitation to overturn *Thornberry*.").

In *Zapara v. Commissioner*, 652 F.3d 1042 (9th Cir. 2011), *nonacq.*, 2013-12 I.R.B. 657, the Court of Appeals for the Ninth Circuit held that the Tax Court had the authority to order an equitable remedy in a CDP case. In that case, after receiving notice of a jeopardy levy on their stock accounts, the taxpayers requested a CDP hearing during which they asked the IRS to sell the stock and use the proceeds to pay their tax liability. "Without mentioning the Zaparas' request to sell, the Appeals Officer issued a Notice of Determination concluding that the Zaparas were precluded from challenging their underlying tax liabilities and that the jeopardy levy would not be withdrawn. The Zaparas appealed to the Tax Court." *Id.* at 1044. The Tax Court found that the IRS had erred by failing to sell the taxpayers' stock within sixty days. The equitable remedy the Tax Court fashioned was ordering "the IRS to credit the Zaparas' tax deficiency for the value of the stock sixty days after the sale request." *Id*. The Tenth Circuit concluded:

> The Tax Court had jurisdiction under 26 U.S.C. section 6330 to review the IRS's failure during a CDP hearing to comply with its mandate under 26 U.S.C. § 6335(f). When the IRS violated its statutory mandate, it assumed the risk of devaluation in the levied property, and the Tax Court appropriately ordered it to credit the Zaparas' outstanding tax liabilities. Because this relief was a specific remedy, 26 U.S.C. § 7433 [providing civil damages for unauthorized collection actions] does not preempt the award.

Id. at 1048. For a discussion of *Zapara* and other CDP cases, see Carlton M. Smith, *The Tax Court Keeps Growing Its Collection Due Process Powers*, 133 TAX NOTES 859 (2011).

In *Weber v. Commissioner*, 138 T.C. 348, 366 (2012), the Tax Court held that it lacked jurisdiction in a CDP case over the taxpayer's claimed overpayment of a trust fund penalty, which the taxpayer claimed should be applied to the income tax liability that had been subject to levy. The court provided numerous reasons for its holding, explaining, in part:

> Mr. Weber . . . asks us not to consider a credit that is already "available" (because it has already been determined) but rather to make "available" a credit that is currently not available because the IRS has disallowed it. He contends that there is a positive balance in his penalty account and that we could decide this case in his favor as an almost arithmetical matter—but that is not the case: Whether the penalty has really been overcollected is a potentially complex question that may depend not only on the balance in his account (which in fact is still negative) but also on the pendency of refund claims by other responsible persons and on liabilities for interest and additions to tax. . . .

Unlike section 6512(b) (which gives us overpayment jurisdiction in a deficiency case), section 6330—the statute conferring our CDP jurisdiction—has no provisions conferring and delimiting any overpayment jurisdiction. Mr. Weber's position would require us to conclude that, in enacting the CDP regime in section 6330, Congress intended to implicitly grant us jurisdiction to adjudicate refund claims for unrelated liabilities. This would contradict our prior holding that "Congress did not intend section 6330 to provide for the allowance of tax refunds and credits". Greene-Thapedi v. Commissioner, 126 T.C. 1, 12 (2006).

Mr. Weber's position would also require us to conclude that, in conferring this supposed CDP overpayment jurisdiction, Congress determined not to circumscribe that jurisdiction (as it circumscribed overpayment jurisdiction in deficiency cases). That is, this supposed grant of CDP overpayment jurisdiction would apparently include no restriction as in section 6512(b)(4) but rather would include the power, in effect, not only to determine an overpayment but also—critical to the relief Mr. Weber seeks—to direct how it shall be

credited. . . . [A] CDP hearing with the expanded reach that Mr. Weber proposes would then not be confined to consideration of "the taxable period to which the unpaid tax specified [in the notice of proposed levy] * * * relates", sec. 6330(b)(2); rather, a CDP hearing could become an almost plenary review of the taxpayer's situation vis-a-vis the IRS for all liabilities and for all periods; and a delinquent taxpayer would have the power to halt IRS collection of any given tax simply by filing a refund claim for any other tax, however unrelated it might be to the tax that the IRS proposed to collect. There is nothing in the text or legislative history of section 6330 to suggest that, in establishing the CDP regime, Congress intended to so constrain the collection of revenue.

In addition, there would be several other practical problems and conceptual anomalies generated by the adjudication of such a claim in this CDP proceeding. First, Mr. Weber waived in writing his right to a CDP hearing before IRS Appeals concerning his penalty liability. That would have been the natural occasion to dispute his liability for this penalty; and if this were a CDP hearing concerning the penalty, that "prior opportunity" would deprive both Appeals and this Court of jurisdiction to entertain his challenge to underlying liability. *See* sec. 6330(c)(2)(B). However, in this collection review case concerning his 2008 income tax, his challenge to liability for the section 6672 penalty is raised as an issue concerning whether the 2008 income tax should be deemed "unpaid", so the congressional intent to offer only one opportunity would be side-stepped, if Mr. Weber's view prevailed.

Id. at 368–70.

The IRS followed *Weber* in a 2012 Chief Counsel Advice memorandum, stating:

> The Tax Court may consider a failure to consider the factual circumstances of a non-CDP year overpayment that could eliminate the CDP year liability to be an abuse of discretion on the part of Appeals. . . . However, this consideration should only include "available credits," such as nonrefunded or not yet applied credits already determined by the IRS or a court, and not merely claims of credits that have not yet materialized. *See* Weber v. Commissioner, 138 T.C. No. 18 (2012) (holding that Tax Court did not have jurisdiction to adjudicate a disputed refund claim that was distinct from and unrelated to the liability at issue).

IRS CCA 201247011, 2012 IRS CCA LEXIS 173 (Nov. 23, 2012).

PROBLEMS

In Part D. of Problem 1 on page 662 of the text, assume that the statute of limitations on collection would otherwise expire on September 12, Year 14 (rather than April 15, Year 14).

§ 17.02 (SECTION 6015)

In 2011, two books were published regarding innocent spouse claims. Frank Agostino reviewed A PRACTITIONER'S GUIDE TO INNOCENT SPOUSE RELIEF: PROVEN STRATEGIES FOR WINNING SECTION 6015 TAX CASES by Robert B. Nadler, concluding, "[b]oth as an introduction to the field and as a comprehensive resource for any practitioner preparing an innocent spouse petition, this book will enable the practitioner to effectively advocate for his client." Frank Agostino, *A Practitioner's Guide to Innocent Spouse Relief*, 2011 TAX NOTES TODAY 121-7 (June 23, 2011).

Robert Wood reviewed INNOCENT SPOUSE: A MEMOIR by Carol Ross Joynt. *See* Robert W. Wood, *Spousal Tax Secrets Exposed: A Review of* Innocent Spouse, 132 TAX NOTES 635 (2011). Although the innocent spouse application process serves largely as a backdrop to the many challenges the author faces, if ever there were a thriller involving occasional appearances by notable tax lawyers, this is it. Wood explains:

> Joynt [a journalist who worked for *Larry King Live*] ends up with ownership of Nathans, a 40-year institution in the Georgetown restaurant and bar scene. That, coupled with her media contacts, guarantees big personalities in the book. (Larry King orders up a helicopter to try to save Mr. Joynt's life.) This entertaining exposé reveals a charming and thoughtful spouse who turns out to have a dark side and many, many financial and tax skeletons.
>
> The book is mostly about the aftermath those skeletons create. When Joynt's husband dies unexpectedly, the tax lawyers (Caplin & Drysdale) explain that he was under criminal investigation by the IRS and in big financial trouble. Although the criminal case is dropped, $3 million will pay the IRS off, they explain. When Joynt says she had no idea about any of her husband's transgressions, the innocent spouse character in the book is born.
>
> Perhaps counterintuitively, it is precisely the elite nature of this Washington insider that makes the book enjoyable and credible. How many putative innocent spouses can ask Watergate reporter Bob Woodward of The Washington Post to read an IRS report about their tax liability? In fact, it is Woodward who suggests that his own tax lawyer—[Sheldon] Cohen—take a look at this mess.

Id. at 635.

For a brief overview of the recent history and evolution of the law governing the availability of innocent spouse relief, see Gary L. Maydew, *A Review of Innocent Spouses—Recent History to the Present*, TAXES, Sept. 2014, at 49, 49–57. The overview concludes with the observation that "in recent years the adjudication of Innocent Spouse cases has become considerably more favorable to those seeking innocent spouse relief." *Id.* at 56. For a criticism of deficiencies in the scope and administration of innocent spouse relief and some proposed reforms, see Stephanie Hunter McMahon, *What Innocent Spouse Relief Says About Wives and the Rest of Us*, 37 HARV. J. L. & GENDER 141 (2014).

§ 17.02[A][1][b] (The Knowledge Element in Section 6015(b))

In *Greer v. Commissioner*, 595 F.3d 338 (6th Cir. 2010), the Court of Appeals for the Sixth Circuit adopted the knowledge standard used by the Ninth Circuit in erroneous deduction cases (the *Price* standard). *Id.* at 347. The Sixth Circuit explained the *Price* approach as follows:

> [I]n erroneous-deduction cases, "[a] spouse has 'reason to know' of the substantial understatement if a reasonably prudent taxpayer in her position at the time she signed the return could be expected to know that the return contained the substantial understatement." [Price v. Commissioner, 887 F.2d 959] at 965 [(9th Cir. 1989)]. It identified four factors to be considered in making that inquiry: (1) the spouse's education, (2) the spouse's involvement in the family's financial affairs, (3) the presence of unusual or lavish expenditures beyond the family's norm, and (4) the other spouse's evasiveness or deceitfulness concerning the family's finances. *Id.*

Id. at 346–47. The Court of Appeals affirmed the Tax Court, which had applied the *Price* test, and also discussed other cases. *See id.* at 348; Greer v. Commissioner, T.C. Memo. 2009-20, 2009 Tax Ct. Memo LEXIS 19, at *12–19. The Court of Appeals explained:

> We think the Tax Court's finding that three of the four factors weighed against Mrs. Greer was incorrect. These factors cannot be discussed in an abstract sense or tallied and set against each other as on a ledger. We must ask whether a reasonable person with the background that emerges from our review of the *Price* factors should have raised a question, upon reviewing the tax filings, about the extent of the benefits claimed therein. . . . Here, we must determine whether Mrs. Greer, knowing that she and her husband earned additional income in 1982 from the . . . sale [of Mr. Greer's closely held business], should have questioned how they nonetheless could claim $33,000 in tax savings for 1982 and $40,000 in carryback refunds for 1979, 1980, and 1981 based on a $50,000 investment [through a partnership (Madison)].
>
> Having reviewed the record, we cannot say that the Tax Court clearly erred in finding that Mrs. Greer should have inquired into the favorable tax benefits thrown off by the Madison investment. First, the low level of taxes owed relative to the income reported on the 1982 return should have given Mrs. Greer

> pause. The front page of the 1982 return reflects an adjustable gross income, *after* deducting $38,726 in losses attributable to the Madison investment, of $183,340. . . . The second page of the return reflects a total tax liability of $32,742. . . . Although the Greers submitted a check for $10,265 to the IRS (the amount due in excess of the tax withheld), the benefits they claimed resulted in an average tax rate of only 17.86% in a year when their income put them in the highest marginal tax bracket, 50% for income over $85,600. . . . Second, the Form 1045 that the Greers filed, carrying Madison-based credits back to 1979 through 1981 and claiming refunds of $33,000, should have raised a question in Mrs. Greer's mind. In addition to reducing their tax burden in 1982, the Greers were able to zero out their income tax for two of the three preceding years. These reductions are reflected clearly on the first page of the Form 1045, at Line 21 in side-by-side columns labeled "Before carryback" and "After carryback," just above Mrs. Greer's signature. . . . Income tax was reduced from $9,654 to $0 for 1979, from $22,161 to $1,363 for 1980, and from $9,082 to $0 for 1981. Over these three years, the couple's adjusted gross income totaled over $220,000. These figures provided the Tax Court adequate grounds for finding that Mrs. Greer, who had sufficient familiarity with financial matters to understand the claimed tax benefits and whose husband neither deceived nor abused her, at least should have inquired into the propriety of the Madison benefits. *See Hayman*, 992 F.2d at 1258–59, 1262 (holding that deductions that reduced tax liability to zero for two years and to near zero for a third year put taxpayer on notice of a possible understatement).

Greer, 595 F.3d at 349–50 (citations and footnotes omitted).

Kellam v. Commissioner, T.C. Memo. 2013-186, 2013 Tax Ct. Memo LEXIS 196, is a recent case in which the knowledge element affected the outcome of the case. In that case, Mr. Kellam requested innocent spouse relief with respect to joint 2007 and 2008 tax returns prepared by his then-wife, Ms. Griffin. On the 2007 return, she failed to report a joint state income tax refund and claimed numerous erroneous deductions, including claiming as charitable contributions "$19,410 for two cars they had given her children." *Id.* at *3. She asked Mr. Kellam whether he wished to review the return and he chose not to. The two shared the resulting federal tax refund. *Id.*

In 2008, the couple separated. Mr. Kellam provided the 2008 W-2 from his job to Ms. Griffin, who prepared and filed a joint return for that year without his input. *Id.* at *3–4, 11. The return claimed numerous erroneous deductions and omitted a joint state income tax refund in the amount of $592. *Id.* at *4.

> After petitioner's 2008 Federal income tax return was filed, but before the refund was received, the Illinois Department of Revenue sought additional tax from Ms. Griffin and petitioner. Ms. Griffin received the Federal tax refund of

> $2,474 and told petitioner she was withholding a portion of his share to pay the State tax. As a result of Ms. Griffin's actions, petitioner received only approximately one-third of the 2008 Federal tax refund.

Id.

After the couple was audited and the IRS denied innocent spouse relief to Mr. Kellam, he petitioned the Tax Court. *Id.* at *5. The court ultimately found that Mr. Kellam was not entitled to relief for 2007 and, in fact, was liable for an accuracy-related penalty (for negligence or disregard of rules or regulations) because he "was at least careless for the 2007 tax year. Mr. Kellam had not made any effort to review the return when given the chance, much less determine whether any of the positions taken were correct." *Id.* at *28–29. However, the court found that for the 2008 tax year:

> Petitioner is . . . relieved of joint and several liability for the understatement of tax attributable to all of the erroneous deductions under section 6015(b) for the 2008 tax year. Further, petitioner validly elected to limit his liability to the portion of the deficiency attributable to him under section 6015(c) and (d). He is liable for a $39.39 deficiency, which is his share of the 2008 deficiency resulting from the unreported State income tax refund.

Id. at *29.

One of the key issues in the case that resulted in different outcomes for the 2007 and 2008 tax years was Mr. Kellam's level of knowledge about the items reported on the return. With respect to 2007:

> Petitioner lived with Ms. Griffin throughout the 2007 tax year and knew enough about the family finances that he should have questioned the legitimacy of the large expenses' qualifying as deductions. Petitioner knew the family had previously purchased two automobiles and that they had been given to Ms. Griffin's children. Petitioner's knowledge of the $10,420 and $8,350 transactions for the cars shows that he was aware of major family expenses. . . .

Id. at *8–9. This contrasted with the situation in 2008:

> Petitioner's situation drastically changed during the 2008 tax year, and he did not know, and did not have reason to know, of the understatement of tax for that year. During the 2008 tax year petitioner separated from Ms. Griffin and she moved out of the marital home. Petitioner did not show the same level of involvement with the family finances in 2008, and Ms. Griffin opened a new bank account in early 2009 for which petitioner was neither an account holder nor an authorized user. All of the 2008 Federal tax refund went directly into Ms. Griffin's account, and

> petitioner received only a small portion of the refund from Ms. Griffin. This factor weighs in favor of relief.

In addition, Ms. Griffin was not evasive about the 2007 tax return: "Petitioner cannot avoid liability by actively electing to be uninformed about the contents of his Federal tax return, especially when he was specifically asked to review it. . . . Further, petitioner directly acknowledged that he would have questioned Ms. Griffin about . . . [an unreimbursed employee business expense] deduction if he had looked at the return before it was filed." *Id.* at *9. By contrast, with respect to 2008, "Ms. Griffin did not deny petitioner access to the bank records, but she was evasive when she filed the joint Federal tax return without his review and did not provide him a copy until two weeks after she had filed it." *Id.* at *11.

In *Wang v. Commissioner*, T.C. Memo. 2014-206, 2014 Tax Ct. Memo LEXIS 202, at *17–24 (Oct. 6, 2014), the Tax Court applied the four *Price* factors that the Sixth Circuit in *Greer* had borrowed from the Ninth Circuit to address whether a requesting spouse had knowledge or reason to know of an understatement. The requesting spouse, Ms. Wang, had served as the office manager for her husband's law firm until he was disbarred for various ethical violations, including misappropriation of client funds. *See id.* at *8–9.

After first concluding that Ms. Wang's level of education and her active involvement in the management of the firm and family finances weighed against her on the knowledge issue (and that the absence of any increase in the couple's standard of living was a neutral factor), the court turned to address Ms. Wang's far more interesting argument bearing on the fourth *Price* factor used in the knowledge inquiry—that her husband's active concealment of financial information from her and his "domineering and controlling attitude" prevented her from participating in household financial decisions:

> Petitioner and intervenor both testified that petitioner had no involvement in the family finances and that intervenor actively prevented petitioner from accessing financial records. Petitioner and intervenor also testified that intervenor had sole control over the firm's financial records as well as the family's bank accounts. Petitioner testified that intervenor was deceptive and controlling and severely limited her autonomy in financial matters and social situations. For example, petitioner testified that intervenor spoke no more than 10 sentences to her at home and never communicated any of his concerns over his legal issues. Petitioner testified that intervenor did not allow her to speak freely outside the home, even going so far as to monitor her conversations with friends. Additionally, she testified that he forbade her from discussing their financial and legal troubles with anyone. However, petitioner gave conflicting testimony on this point, stating that she chose not to discuss family matters with friends because (i) she wished to bring business to intervenor's law firm and did not want to harm his reputation, and (ii) she believes "Chinese people" generally do not discuss family matters outside the home. Petitioner also testified that she told a college

> friend about her husband's disbarment and that this friend helped intervenor find his current employment.
>
> Petitioner and intervenor's testimonies are not convincing. The record reflects that petitioner was involved in the daily operations of intervenor's law firm. Additionally, intervenor stated during his bankruptcy deposition that petitioner was his "office manager" and that he and petitioner "talk about office stuff all the time". Petitioner's testimony that she and intervenor discussed his legal troubles daily runs counter to her allegation that he rarely spoke to her. Despite intervenor's supposed deceit, petitioner testified that she is currently allowing him to handle the sale of their home and any transactions related to the alleged foreclosure.
>
> Petitioner asks the Court to find that intervenor concealed financial information from her and that his domineering and controlling attitude prevented her from participating in household financial decisions. Petitioner's failure to ask questions of intervenor does not necessarily mean that intervenor was deceptive or evasive. For example, petitioner testified that since she did not have any formal education with regard to finances and law, and since English is not her first language, she trusted intervenor to handle all of the family finances. Petitioner also testified that she preferred to "keep the peace" and therefore did not discuss politics and money with intervenor. As was the case with the taxpayer in *Doyle v. Commissioner*, 94 Fed. Appx. at 952, petitioner chose to play the "ostrich, hiding her head in the proverbial sand." The fact that petitioner trusted intervenor with financial decisions is insufficient to qualify her for relief under section 6015(b)(1)(C). *See also Greer v. Commissioner*, 595 F.3d at 351 ("Being a homemaker cannot alone relieve a spouse of joint and several tax liability."). Additionally, by signing the 2008 tax return without reviewing it, petitioner is charged with constructive knowledge of its contents. *See Crouse v. Commissioner*, T.C. Memo. 2011-97, slip op. at *42 (citing *Bokum v. Commissioner*, 94 T.C. 126, 148 (1990)), *aff'd*, 992 F.2d 1132 (11th Cir. 1993).

Id. at *22–24. Accordingly, the court concluded that three of the four *Price* factors weighed heavily against Ms. Wang's argument that she lacked knowledge or reason to know of the understatements on the joint returns filed on behalf of herself and her husband for the two tax years in question and therefore precluded relief under section 6015(b). *Id.* at *24.

Varela v. Commissioner, T.C. Memo 2014-222, 2014 Tax Ct. Memo LEXIS 218, at *14 (Oct. 22, 2014), is an example of a case where the requesting spouse was granted full immunity for tax deficiencies and assessed accuracy-related penalties based on the court's conclusion that she had no knowledge or reason to know of the understatements on her and her husband's joint tax returns for the years in question. Ms. Varela's husband was the sole shareholder and president of a Texas corporation engaged in the building of homes. *Id.* at *10. Although Ms.

Varela was formally listed as an incorporator and director in the corporation's records, at trial she testified that she was not in fact employed by the corporation and had performed no services for the company other than to assist a newly-hired office manager in organizing the company's paperwork on one occasion. *Id.* *4–5, *10. She also testified that she never received any dividends and had no access to corporate records, books, or accounts. *Id.* at *5. There was additional evidence that beginning several years prior to the tax years in question, Ms. Varela and her husband began keeping separate checking and credit card accounts, that the paychecks from her separate employment were regularly deposited into her own accounts, and that she and her husband agreed to split household and other expenses roughly evenly between them. *See id.* at *4.

The understatements at issue primarily concerned expense deductions for rental properties that were owned jointly by Ms. Varela and her husband but that were managed exclusively by the company's employees, with all rents and proceeds from the properties being deposited into company accounts or the husband's own accounts— neither of which were accessible by Ms. Varela. *Id.* at *11. Although the court did not cite to the *Price* factors in its analysis, it concluded that by Ms. Varela's credible testimony and all the evidence tending to show that she had no access to or control over the rental properties or the company's finances were sufficient to support the conclusion that she did not know of, or have any reason to know of, the understatements. *Id.* at *11–13.

§ 17.02[A][3] (Section 6015(f))

In early 2012, the IRS issued a proposed Revenue Procedure containing revisions to the factors relevant to section 6015(f) claims. *See* Chief Counsel Notice 2012-8, 2012-4 I.R.B. 309, 2012 IRB LEXIS 18. The proposed Revenue Procedure was intended to update Revenue Procedure 2003-61, discussed in the text. It has since been finalized, with some changes, as discussed below. *See* Rev. Proc. 2013-34, 2013-2 C.B. 397, 2013 IRB LEXIS 478.

The Chief Counsel Notice listed ten proposed changes to the Revenue Procedure but emphasized a new approach to taking into account spousal abuse and financial control of the requesting spouse. The Notice explained:

> Significantly, this proposed revenue procedure expands how the IRS will take into account abuse and financial control by the nonrequesting spouse in determining whether equitable relief is warranted. Review of the innocent spouse program demonstrated that when a requesting spouse has been abused by the nonrequesting spouse, the requesting spouse may not have been able to challenge the treatment of any items on the joint return, question the payment of the taxes reported as due on the joint return, or challenge the nonrequesting spouse's assurance regarding the payment of the taxes. Review of the program also highlighted that lack of financial control may have a similar impact on the requesting spouse's ability to satisfy joint tax liabilities. As a result, this proposed

revenue procedure provides that abuse or lack of financial control may mitigate other factors that might otherwise weigh against granting equitable relief under section 6015(f).

> The proposed revenue procedure also provides for certain streamlined case determinations; new guidance on the potential impact of economic hardship; and the weight to be accorded to certain factual circumstances in determining equitable relief.

Id. In addition, the proposed Revenue Procedure was designed to apply to understatements of income tax, not just underpayments, and to claims for equitable relief under Code section 66(c) (involving spousal liability for community income). *Id*.

In September 2013, the IRS finalized the updated Revenue Procedure as Revenue Procedure 2013-34, as indicated above. The new Revenue Procedure reflects a few changes from Notice 2012-8 and lists twelve "significant" changes from its predecessor. *Id.* at *6–13. One of those is the limitations period under Section 6015(f), which is discussed below in Section 17.02[B][1] of this Supplement. *Id.* at 7. The role of knowledge on the part of the electing spouse and abuse by the other spouse are among the significant changes from Revenue Procedure 2003-61:

> .07 The knowledge factor for understatement cases in section 4.03(2)(c)(i) of this revenue procedure clarifies how the factor works in cases involving equitable relief under section 66(c), in addition to cases involving equitable relief under section 6015(f). Section 4.03(2)(c)(i)(A) provides that actual knowledge of the item giving rise to an understatement or deficiency will no longer be weighed more heavily than other factors, as it did under Rev. Proc. 2003-61. Further, section 4.03(2)(c)(i)(A) clarifies that, for purposes of this factor, if the nonrequesting spouse abused the requesting spouse or maintained control over the household finances by restricting the requesting spouse's access to financial information, and because of the abuse or financial control, the requesting spouse was not able to challenge the treatment of any items on the joint return for fear of the nonrequesting spouse's retaliation, then that abuse or financial control will result in this factor weighing in favor of relief even if the requesting spouse knew or had reason to know of the items giving rise to the understatement or deficiency.
>
> .08 The knowledge factor for underpayment cases in section 4.03(2)(c)(ii) of this revenue procedure now provides that, in determining whether the requesting spouse knew or had reason to know that the nonrequesting spouse would not pay the tax reported as due on the return, the Service will consider whether the requesting spouse reasonably expected that the nonrequesting spouse would pay the tax liability at the time the return was filed or within a reasonable period of time after the filing of the return. In response to comments received with respect

> to Notice 2012-8, section 4.03(2)(c)(ii) provides that a requesting spouse may be presumed to have reasonably expected that the nonrequesting spouse would pay the liability if a request for an installment agreement to pay the tax was filed by the later of 90 days after the due date for payment of the tax, or 90 days after the return was filed. Further, section 4.03(2)(c)(ii) clarifies that for purposes of this factor, if the nonrequesting spouse abused the requesting spouse or maintained control over the household finances by restricting the requesting spouse's access to financial information, and because of the abuse or financial control, the requesting spouse was not able to question the payment of the taxes reported as due on the return or challenge the nonrequesting spouse's assurance regarding payment of the taxes for fear of the nonrequesting spouse's retaliation, then that abuse or financial control will result in this factor weighing in favor of relief even if the requesting spouse knew or had reason to know that the nonrequesting spouse would not pay the tax liability. Finally, section 4.03(2)(c)(ii) provides that if the requesting spouse did not reasonably expect that the nonrequesting spouse would pay the tax liability reported on an amended return that was based on items not properly reported on the original return, the Service will also consider whether the requesting spouse knew or had reason to know of the understatement on the original return.

Id. at *9–11.

Revenue Procedure 2013-34 "is effective for requests for relief filed on or after September 16, 2013. In addition, this revenue procedure is effective for requests for equitable relief pending on September 16, 2013 whether with the Service, the Office of Appeals, or in a case docketed with a Federal court." *Id.* at *37–38. Before that, Notice 2012-8 generously provided:

> Because the provisions in the proposed revenue procedure expand the equitable relief analysis by providing additional considerations for taxpayers seeking relief, until the revenue procedure is finalized, the Service will apply the provisions in the proposed revenue procedure instead of Rev. Proc. 2003-61 in evaluating claims for equitable relief under section 6015 (f). If taxpayers conclude that they would receive more favorable treatment under one or more of the factors provided in Rev. Proc. 2003-61 they should advise the Service in their application for relief or supplement an already existing application. Then the Service will apply those factors from Rev. Proc. 2003-61, until a new revenue procedure is finalized.

Chief Counsel Notice 2012-8, *supra* at *3.

A 2014 article describes how Rev. Proc. 2013-34 expanded the availability of refunds in cases involving deficiencies:

> Rev. Proc. 2013-34 expands the availability of refunds in cases involving deficiencies by eliminating the earlier requirement that limited refunds in deficiency cases to payments the requesting spouse made under an installment agreement. The requesting spouse is not entitled to a refund of any payments made by the nonrequesting spouse, but if the requesting spouse used his or her funds to make an overpayment for another tax year that was applied to the joint income tax liability, the requesting spouse may be eligible for a refund.

Robin Clark & Darlene Pulliam, *Innocent Spouse Relief Under Rev. Proc. 2013-3*, 45 TAX ADVISER 810 (2014), *available at* http://www.aicpa.org/publications/taxadviser/2014/november/pages/pulliam_nov14.aspx.

A 2014 Tax Court Summary Opinion explains the overall approach of Revenue Procedure 2013-34 as follows:

> Rev. Proc. 2013–34 . . . provides a three-step analysis to follow in evaluating a request for relief. The first step consists of seven threshold conditions that must be met: (1) the requesting spouse filed a joint return for the taxable year for which he or she seeks relief; (2) relief is not available to the requesting spouse under section 6015(b) or (c); (3) the claim for relief is timely filed; (4) no assets were transferred between the spouses as part of a fraudulent scheme by the spouses; (5) the nonrequesting spouse did not transfer disqualified assets to the requesting spouse; (6) the requesting spouse did not knowingly participate in the filing of a fraudulent joint return; and (7) absent certain enumerated exceptions, the tax liability from which the requesting spouse seeks relief is attributable to an item of the nonrequesting spouse. *Id.* sec. 4.01, 2013–43 I.R.B. at 399–400.
>
> The second step of the analysis provides the following three conditions that, if met, will qualify a requesting spouse for a streamlined determination of relief under section 6015(f) with respect to an underpayment of a properly reported liability: (1) he or she is no longer married to, is legally separated from, or has not been a member of the same household as the other person at any time during the 12-month period ending on the date of the request for relief; (2) he or she would suffer economic hardship if relief is not granted; and (3) in a deficiency case such as this, he or she had no knowledge or reason to know when the return was filed that there was an understatement or deficiency. . . .
>
> The third step is available if the requesting spouse satisfies the threshold conditions but fails to satisfy the conditions in Rev. Proc. 2013–34, sec. 4.02. A requesting spouse may still be eligible for equitable relief under section 6015(f) if, taking into account all the facts and circumstances, it would be inequitable to hold the requesting spouse liable for the underpayment. *Id.* sec. 4.03, 2013–43 I.R.B.

> at 400. Rev. Proc. 2013–34, sec. 4.03 lists the following nonexclusive factors that the Commissioner takes into account when determining whether to grant equitable relief: (1) marital status; (2) economic hardship; (3) in the case of a deficiency knowledge or reason to know of the item giving rise to the deficiency; (4) legal obligation; (5) significant benefit; (6) compliance with tax laws; and (7) mental or physical health. *Id.* No single factor is determinative; the Internal Revenue Service (IRS) considers all factors and weighs them appropriately. *Id.* Any indication of abuse or the exercise of financial control by the nonrequesting spouse is a factor that may impact the other factors. *Id.*

Howerter v. Commissioner, T.C. Summary Op. 2014-15, 2014 Tax Ct. Summary LEXIS 15, at *14–15.

In *Howerter*, the court found in favor of the requesting spouse and suggested that the revised Revenue Procedure tipped the balance:

> Three of the factors are neutral, three weigh in favor of granting relief to petitioner, and one weighs against granting relief. The only factor weighing against relief is the knowledge factor. Rev. Proc. 2013-34, *supra*, makes clear that, *in the Commissioner's determination under section 6015(f), knowledge of the item giving rise to an understatement or deficiency will no longer weigh more heavily than other factors*, as it did under Rev. Proc. 2003-61, *supra*. Rev. Proc. 2013-34, sec. 3.07, 2013-43 I.R.B. at 398. Balancing all of the facts and circumstances we find that the equities favor granting petitioner relief under section 6015(f).

Id. at *22 (emphasis added).

Similarly, in *Demeter v. Commissioner*, T.C. Memo. 2014-238, 2014 Tax Ct. Memo LEXIS 236, at *13–16, 21 (Nov. 24, 2014), the requesting spouse was accorded relief from joint and several liability despite the court's conclusion that she knew or had reason to know as of the date her ex-husband filed their joint tax returns that he would not pay the full tax liability actually due. The court's decision to grant relief notwithstanding that knowledge was based on its consideration of the following equities in her favor, in accordance with section 4.03 of Revenue Procedure 2013-34: (1) She had divorced her husband before requesting innocent spouse relief and (2) She was likely to suffer economic hardship because she was receiving food assistance, was unemployed, was responsible for two minor children, and had yet to receive alimony or child support payments due from her ex-husband. *See id.* at *12–13. *Cf.* Raschke v. Comm'r, T.C. Summ. Op. 2014-32, 2014 Tax Ct. Summary LEXIS 32, at *22 (Apr. 7, 2014) (requesting spouse granted equitable relief under section 6015(f) despite knowledge of understatement of income on joint return when requesting spouse demonstrated existence of economic hardship and his health conditions limited his ability to find full-time employment).

By contrast, the Court of Appeals for the Ninth Circuit recently affirmed the Tax Court's decision in favor of the IRS in *Deihl v. Commissioner*, No. 12-74169, 2015 U.S. App. LEXIS 2953 at *1 (9th Cir. Feb. 24, 2015). In that case, the requesting spouse had made claims under both section 6015(c) and (f). *Id.* at *2. With respect to her abuse claim under section 6015(f), the court stated:

> A taxpayer's entitlement to innocent spouse relief "often turns on credibility, which is best tested in the crucible of trial . . . ." *Wilson v. Comm'r,* 705 F.3d 980, 993 (9th Cir.2013). . . . The Tax Court's decision to deny Appellant's petition rested on its determination, as the finder of fact, that Appellant's and her son's testimony was self-interested and unsubstantiated, and therefore, not credible. . . . Appellant did not substantiate her claims of abuse with disinterested third-party testimony or documentary evidence. Further, Appellant's contention that she played no meaningful role in her husband's business decisions was inconsistent with record evidence showing that she drew a salary from the couple's business, planned and hosted business events, wrote corporate checks, and presented herself to the public as a co-founder and CEO.

Id.

In *Wang v. Commissioner*, discussed in section 17.02[A][1][b], *supra*, the requesting spouse asked the Tax Court to consider her husband's alleged psychological abuse of her when considering her alternative argument for equitable relief under Code section 6015(f). 2014 Tax Ct. Memo LEXIS 202, at *43. Interestingly, she also asked the court to consider a factor in addition to those actually enumerated in section 4.03 of Revenue Procedure 2013-34: "efficient tax administration." *Id.* Turning first to the issue of her spouse's alleged abuse, the court stated:

> Petitioner asks us to consider the additional factor of abuse. The Court may consider abuse of the requesting spouse by the nonrequesting spouse as a factor in determining whether to grant equitable relief. *See Sriram v. Commissioner*, T.C. Memo. 2012-91. Additionally, Rev. Proc. 2013-34, *supra*, notes that, as a significant change from Rev. Proc. 2003-61, *supra*, the presence of abuse is to be given "greater deference". Further, Rev. Proc. 2013-34, sec. 4.03, states that "[a]buse comes in many forms and can include physical, psychological, sexual, or emotional abuse, including efforts to control, isolate, humiliate, and intimidate the requesting spouse, or to undermine the requesting spouse's ability to reason independently and be able to do what is required under the tax laws." All facts and circumstances are to be taken into account in determining the presence of abuse. *Id.*
>
> Petitioner argues for the first time in posttrial briefing that she was the victim of psychological and mental abuse by intervenor. Petitioner's Form 8857 states that she was not the victim of spousal abuse or domestic violence, and

> petitioner stipulated this fact. Petitioner's testimony reflects that she is not satisfied with her marriage to intervenor. Additionally, petitioner testified that intervenor limited her autonomy. However, it is a far step from concluding that petitioner's marriage is unsatisfactory to concluding that she has suffered mental and psychological abuse by intervenor, particularly when she previously represented that there was no abuse by intervenor. From all of the facts and circumstances presented to the Court, we cannot conclude that she has established the presence of abuse. Accordingly, this factor is neutral.

Id. at *44–45 (alteration in original).

With respect to her argument that granting her equitable relief would be conducive to "effective tax administration," the court had the following to say:

> Petitioner argues for an additional factor, "effective tax administration." Petitioner states that she will divorce intervenor if granted equitable relief and "the Court should not create another reason to bind . . . [petitioner] to . . . [intervenor]." Additionally, petitioner argues that "the Court should feel secure that both the Government's and . . . [petitioner]'s interests are being adequately protected by granting her equitable relief that will allow her to finally pursue her personal and financial freedom."
>
> The Court will not engage in hypotheticals regarding the future of petitioner's marriage, particularly because of our concerns about the parties' credibility. While the Court recognizes that financial considerations (e.g., tax liabilities) may weigh in a person's decision to divorce, this Court has no proper role to play in that decision. Additionally, it would be inappropriate for the Court to base its holding on grounds that could be perceived as either encouraging or discouraging divorce. We therefore do not consider this factor.

Id. at *45–46 (alterations in original) (quoting Petitioner's Brief).

The court concluded by denying Ms. Wang's request for equitable relief under section 6015(f) because, of the factors explicitly enumerated in section 4.03 of Revenue Procedure 2013-43, four were neutral, two (her actual or constructive knowledge of the understatement and her failure to comply with state income tax laws) weighed against her, and only one (the absence of a significant benefit from the understatement) weighed in her favor. *Id.* at *43.

An academic recently surveyed every Tax Court decision decided under Revenue Procedure 2013-43 as of October 20, 2014 that discusses equitable relief factor analysis, and concluded that the more lenient rules offered by Revenue Procedure 2013-43 have "resulted in the [Tax C]ourt granting relief to requesting spouses in instances when it would not have previously." Wei-Chih Chiang, *New Innocent Spouse Equitable Relief Rules in Judicial Practice*, 146 TAX NOTES 113, 117 (2015). However, the author also concluded that the "cases still weigh the lack of economic hardship against granting equitable relief and weigh actual knowledge more heavily than other factors in deciding whether to grant equitable relief." *Id.* Moreover, the cases applying the Revenue Procedure were small tax cases, the decisions in which lack precedential value. *Id.*

There is a longstanding controversy over the issue of the Tax Court's standard and scope of review of section 6015(f) cases. The Tax Court held in *Porter v. Commissioner*, 132 T.C. 203 (2009) (reviewed by the court), that de novo review applied. The court referred to 2006 amendments to section 6015, and stated, "[n]othing in amended section 6015(e) suggests that Congress intended us to review for abuse of discretion." *Id.* at 208. Noting that the court has "always applied a de novo scope and standard of review in determining whether relief is warranted under subsections (b) and (c) of section 6015," the majority concluded that taxpayers seeking relief under section 6015(f) should receive "similar treatment and thus the same standard of review." *Id.* at 210. Six judges joined in two dissenting opinions on this issue. *See id.* at 221–39. The Court of Appeals for the Ninth and Eleventh Circuits subsequently agreed with the Tax Court. *See* Wilson v. Commissioner, 705 F.3d 980, 992 (9th Cir. 2013); Commissioner v. Neal, 557 F.3d 1262 (11th Cir. 2009).

Initially, the IRS disagreed. In Chief Counsel Notice CC-2009-021, *available at* 2009 TAX NOTES TODAY 125-5 (July 2, 2009), the IRS noted its disagreement with the holding in *Porter* and advised its attorneys to continue arguing that under an abuse of discretion standard of review, the scope of the Tax Court's review is limited to issues and evidence presented before Appeals or Examinations. *Id.* However, in June 2013, the IRS changed course and issued Chief Counsel Notice CC-2013-11, 2013 CCN LEXIS 8, which obsoleted the 2011 Chief Counsel Notice. The IRS also acquiesced in the Ninth Circuit's decision in *Wilson. See* AOD-2012-07, *available at* 2013 TAX NOTES TODAY 108-22 (June 5, 2013) ("Although the Service disagrees that section 6015(e)(1) provides both a de novo standard and a de novo scope of review, the Service will no longer argue that the Tax Court should review section 6015(f) cases for an abuse of discretion or that the court should limit its review to the administrative record.").

Citing *Porter*, the 2013 Notice explains that both the scope and standard of review in section 6015(f) cases are *de novo*. *Id.* at *1. It instructs Chief Counsel attorneys to "no longer argue that the Tax Court should review the Service's section 6015(f) determinations for abuse of discretion or that the court should limit its review to evidence in the administrative record." *Id.* at *1–2. The Notice also provides guidance regarding the procedure for requesting a determination of relief and litigating section 6015 cases. *Id.* at *2–5. For a short additional discussion of Notice 2013-11, see Susan Simmonds, *IRS Drops Procedural Arguments in Equitable Innocent Spouse Cases*, 139 TAX NOTES 1503 (2013).

§ 17.02[B][1] (Timing of the Innocent Spouse Claim)

The period within which to request relief under section 6015(f) has been evolving. Revenue Procedure 2003-61, discussed in the text on pages 680–81, sets out seven threshold conditions for relief under 6015(f), including a claim filed within a two-year limitations period. As discussed above in Section 17.02[A][3] of this Supplement, that Revenue Procedure has been superseded by Revenue Procedure 2013-34, 2013-2 C.B. 397, 2013 IRB LEXIS 478, which provides for a limitation period that is based on the statute of limitation on collection or refunds:

> The claim for relief is timely filed:
>
> (a) If the requesting spouse is applying for relief from a liability or a portion of a liability that remains unpaid, the request for relief must be made on or before the Collection Statute Expiration Date (CSED). The CSED is the date the period of limitation on collection of the income tax liability expires, as provided in section 6502. Generally, that period expires 10 years after the assessment of tax, but it may be extended by other provisions of the Internal Revenue Code.
>
> (b) Claims for credit or refund of amounts paid must be made before the expiration of the period of limitation on credit or refund, as provided in section 6511. Generally, that period expires three years from the time the return was filed or two years from the time the tax was paid, whichever is later.

Id. at *14–15.

The Treasury Department also issued proposed regulations reflecting the change in the Section 6015(f) limitation period. *See* REG-132251-11, *available at* 2013 TAX NOTES TODAY 156-4 (Aug. 13, 2013). The proposed regulations provide in part:

> To request equitable relief under section 1.6015-4, a requesting spouse must file Form 8857 . . . or other similar statement with the IRS within the period of limitation on collection of tax in section 6502 or within the period of limitation on credit or refund of tax in section 6511, as applicable to the joint tax liability. If a requesting spouse files a request for equitable relief under section 1.6015-4 within the period of limitation on collection of tax, the IRS will consider the request for equitable relief, but the requesting spouse will be eligible for a credit or refund of tax only if the limitation period for credit or refund of tax is open when the request is filed (assuming all other requirements are met, including the limit on amount of credit or refund prescribed in section 6511(b)(2)). Alternatively, if a requesting spouse files a request for equitable relief after the period of limitation on collection of tax has expired but while the limitation period on credit or refund of tax remains open, the IRS will consider the request for equitable relief insofar as tax was paid by or collected from the requesting spouse, and the requesting spouse will be eligible for a potential credit or refund of tax. . . .

Id. The Treasury has received a number of comments on the proposed regulations. *See, e.g.*, *Low-Income Taxpayer Clinicians Suggest Changes to Proposed Regs on Innocent Spouse Relief*, 2014 TAX NOTES TODAY 22-64 (Jan. 30, 2014); *Florida Bar Tax Section Comments on Equitable*

Innocent Spouse Relief, 2013 TAX NOTES TODAY 219-17 (Nov. 13, 2013).

The history of the government's departure from the two-year limitation period is as follows: In 2009, the Tax Court struck down the two-year period for Section 6015(f) claims, which was also contained in Treasury Regulation section 1.6015-5(b)(1). *See* Lantz v. Commissioner, 132 T.C. 131 (2009) (reviewed by the court), *rev'd and remanded*, 607 F.3d 479 (7th Cir. 2010). Mrs. Lantz was a homemaker married to a dentist who was convicted of Medicare fraud. *Id.* at 131–32. She sought relief under section 6015(f) with respect to the joint 1999 tax year. The IRS denied her request on the ground that she had not requested relief within two years of the time the IRS took a collection action for the joint tax liability. *Id.* at 133. The Tax Court explained that it had never been faced with a direct challenge of the limitations period, *id.* at 136, and concluded that Congress did not intend for a limitation period to apply to section 6015(f), an equitable relief provision that requires a broad look at the facts and circumstances, *id.* at 140. It stated:

> To be eligible for relief under section 6015(b) or (c), the statute explicitly provides that the requesting spouse must elect relief not later than the date that is 2 years after the date the Secretary has begun collection activities with respect to the individual making the election. Sec. 6015(b)(1)(E) and (c)(3)(B). However, there is no such limitation in section 6015(f). "'It is generally presumed that Congress acts intentionally and purposely' when it 'includes particular language in one section of a statute but omits it in another'". *City of Chicago v. Envtl. Def. Fund*, 511 U.S. 328 . . . (1994) (quoting *Keene Corp. v. United States*, 508 U.S. 200, 208 . . . (1993)). *We find that by explicitly creating a 2-year limitation in subsections (b) and (c) but not subsections (f), Congress has "spoken" by its audible silence*. Because the regulation imposes a limitation that Congress explicitly incorporated into subsections (b) and (c) but omitted from subsections (f), it fails the first prong of *Chevron* [*U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984)].

Id. at 138–39 (emphasis added). The *Chevron* standard of deference is discussed in detail in Section 2.02 of the text.

The invalidation of this time limitation met with opposition. Several Tax Court judges dissented. *See id.* at 150–61 (opinions of dissenting judges). In addition, in Chief Counsel Notice CC-2009-012 (April 17, 2009), *available at* 2009 TAX NOTES TODAY 75-7 (Apr. 22, 2009), the IRS expressed its disagreement with the Tax Court's holding in *Lantz*. In advising its attorneys on how to handle Tax Court cases in which a petitioner seeks equitable innocent spouse relief more than two years after the first collection activity, the Chief Counsel's office directed attorneys to continue to argue at trial that relief under section 6015(f) is unavailable if the petitioner files outside the two-year period. *Id.*

The Tax Court followed its decision in *Lantz* in *Mannella v. Commissioner*, 132 T.C. 196

(2009), *rev'd*, 631 F.3d 115 (3d Cir. 2011). The Tax Court also held that actual notice of collection procedures is not required to trigger the beginning of the two-year limitation period for subsections 6015(b) and (c). Looking to the regulations, the court found that a notice of intent to levy started the 30 day period to request an Appeals hearing if it was properly sent to the taxpayer's last known address; actual receipt is not required. *Id.* at 200. It explained:

> We see no reason the notice of intent to levy, including information about her right to section 6015 relief, mailed to petitioner at her last known address but not received by her should start the 30-day period to request an Appeals hearing but not start the 2-year period to request relief under section 6015(b) or (c). Nothing in section 6015 or the corresponding regulations requires that petitioner actually receive the notice of intent to levy for the 2-year period to begin. We conclude that her actual receipt of the notice of intent to levy is not required for the 2-year period in which to request relief under section 6015(b) or (c) to begin.

Id.

The government appealed *Lantz* to the Seventh Circuit, where it prevailed. Lantz v. Commissioner, 607 F.3d 479 (7th Cir. 2010) (reversing and remanding to the Tax Court). In an opinion by Judge Posner, the court upheld Treasury Regulation 1.6015-5(b)(1)'s two-year limitations period, finding:

> In short, if there is no deadline in subsection (f), the two-year deadlines in subsections (b) and (c) will be set largely at naught because the substantive criteria of those sections are virtually the same as those of (f).
>
> Subsection (f), in contrast to (b) and particularly (c), is brief, probably because it's a safety-valve provision for innocent spouses who fall through cracks in (b) or (c). The details of the safety valve were left to the Treasury Department to work out and an important detail—the deadline for application—was created by the Treasury regulation that the Tax Court has invalidated.

Id. at 484. The Court of Appeals also criticized the Tax Court's opinion, stating:

> [E]ven if our review of statutory interpretations by the Tax Court were deferential, we would not accept "audible silence" as a reliable guide to congressional meaning. "Audible silence," like Milton's "darkness visible" or the Zen *koan* "the sound of one hand clapping," requires rather than guides interpretation. Lantz's brief translates "audible silence" as "plain language," and adds (mysticism must be catching) that "Congress intended the plain language of the language used in the statute."
>
> Whatever any of this means, the Tax Court's basic thought seems to have been that since some statutes (in this case, some provisions of a statute) prescribe

> deadlines, whenever a statute (or provision) fails to prescribe a deadline, there is none. That is not how statutes that omit a statute of limitations are usually interpreted.

Id. at 481. For an argument that the Tax Court was right in *Lantz* and the Seventh Circuit was wrong, see Bryan T. Camp, *Interpreting Statutory Silence*, 128 TAX NOTES 501 (2010).

The government also prevailed on appeal to the Third Circuit in *Mannella*, 631 F.3d 115 (3d Cir. 2011), *rev'g* 132 T.C. 196 (2009). The Third Circuit determined that regulation section 1.6015-5(b)(1) is a proper implementation of section 6015. *Id.* at 117. The court held that "the regulation is neither contrary to nor an impermissible implementation of section 6015," *id.*, and discussed the Seventh Circuit's opinion in *Lantz*, *id.* at 121. The court did, however, remand the case to the Tax Court for its consideration of an equitable tolling contention raised by the taxpayer on appeal. *Id.* at 117. In addition, the government prevailed on appeal to the Fourth Circuit in *Jones v. Commissioner*, 642 F.3d 459, 464–65 (4th Cir. 2011) (applying *Chevron*, finding the statute ambiguous and upholding the regulation as a valid gap-filler). For a discussion of how Judge Ambro's dissent in the Third Circuit's decision in *Mannella*, which determined that the two-year time limit in the regulation governing section 6015(f) relief failed under step two of *Chevron*, adds to the discussion, see Patrick J. Smith, Mannella, State Farm, *and the Arbitrary and Capricious Standard*, 2011 TAX NOTES TODAY 80-6 (April 26, 2011).

On May 5, 2011—a few months after the Third Circuit's decision in *Mannella*—the Tax Court decided *Pullins v. Commissioner*, 136 T.C. 432 (2011), again holding that regulation 1.6015-5(b)(1) is invalid. In that case, the taxpayer requested section 6015 relief nearly four and a half years after IRS collection activities had begun. *Id*. at 436. True to form, the IRS denied the taxpayer's request because she did not request relief within two years of the IRS's first collection activity, as required by the regulation in question. *Id.* at 433.

The Tax Court reviewed the "three-step analysis for IRS personnel to follow in evaluating requests for [innocent spouse] relief," *id.* at 439, and again held that "the two-year deadline imposed by [regulation 1.6015-5(b)(1)] is an invalid interpretation of section 6015(f)." *Id.* at 440. The court to which the case at bar was appealable—the Court of Appeals for the Eighth Circuit—had not yet ruled on the issue. Noting that fact, the Tax Court again followed its own holding in *Lantz*. *Id*. Without the statute of limitations as a barrier, the court conducted an analysis of the taxpayer's eligibility for innocent spouse relief and concluded that "it would be inequitable to hold Ms. Pullins liable for the 1999, 2002, and 2003 tax liabilities." *Id.* at 455.

Also in 2011, IRS Commissioner Douglas Shulman sent a letter responding to three Senators and 49 House members (all Democrats) who in April 2011 had asked the IRS to withdraw the two-year limit. Shulman said that the IRS would review the rule. *See Shulman Tells Lawmakers IRS is Reviewing Innocent Spouse Rules*, 2011 TAX NOTES TODAY 86-4 (May 4, 2011); *Baucus, Harkin, Sherrod Brown Call on IRS to Give Innocent Spouses More Time to File For Tax Relief,* Committee on Finance News Release (April 18, 2011), *available at* http://finance.senate.gov/newsroom/chairman/release/?id=83b847fd-d72b-4b58-9fcb-4e44351c2a63.

The issue was also on appeal to the Second Circuit (*Coulter v. Commissioner*, Tax Court Docket No. 1003-09, appeal docketed, No. 10-680 (2d Cir. Feb. 12, 2010)). There was some speculation that the Second Circuit might uphold the Tax Court's position, creating a split in the circuits. *See* Shamik Trivedi & Michael Beller, *IRS Scraps 2-Year Time Limit for Equitable Innocent Spouse Relief*, 132 TAX NOTES 489, 489 (2011). Nina Olson, a vocal advocate for repealing the two-year deadline wrote:

> "Is this the case you want to go to the Supreme Court? A taxpayer represented by a low-income tax clinic, is a victim of domestic abuse, and the IRS is sticking it to them?" she asked. "Is this the story you want of the kinder, gentler IRS?"

Year in Review: IRS Gives in on Innocent Spouse, 2012 TAX NOTES TODAY 1-13 (Jan. 3, 2012) [hereinafter *IRS Gives in on Innocent Spouse*].

In July 2011, the IRS issued Notice 2011-70, 2011-2 C.B. 135, which withdrew its position on the time limitation, and the Justice Department filed a motion for dismissal of the *Coulter* appeal. *See id*. The Notice provided a number of transitional rules to assist taxpayers whose claims had been denied under the two-year rule and stated

> Treasury and the IRS have concluded that the regulations issued under section 6015 should be revised so that individuals who request equitable relief under section 6015(f) will no longer be required to submit a request for equitable relief within two years of the IRS's first collection activity against the requesting spouse with respect to the joint tax liability.

Notice 2011-70, *supra*.

Furthermore, then-IRS Commissioner Douglas Shulman, in a statement announcing the July notice, agreed with the need for changes to the innocent spouse regime: "'We know these are difficult situations for people to face, and [these] changes will help innocent spouses victimized in the past, present and the future.'" *IRS Gives in on Innocent Spouse*, *supra*.

Under the transitional rules, requests for relief were treated differently depending on the stage the case was at when the IRS issued the notice. *See* Notice 2011-70, *supra*. In *Haag v. United States*, 2012 U.S. Dist. LEXIS 113411, 2012-2 U.S. Tax Cas. (CCH) ¶ 50,519 (D. Mass. Aug. 13, 2012), where the taxpayer's innocent spouse claim was adjudicated and finalized prior to the issuance of Notice 2011-70, the court held that the taxpayer could not rely on the Notice. The court adopted the First Circuit's reasoning in a related case, explaining:

> "With regards to the specific matter of innocent spouse claims that were adjudicated and rendered final prior to its date of issue, Notice 2011-70 explains that the IRS will not take further collection activity against a taxpayer *if* the

> agency had 'stipulated in the court proceeding that the individual's request for equitable relief would have been granted had the request been timely.' In Haag's case, the IRS never stipulated that § 6015(f)'s two-year deadline constituted the sole obstacle to her claim. On the contrary, we note that in the *Haag I* litigation, the government argued that Haag administratively waived her claim by not articulating her request for relief before the Secretary prior to raising it at the district court."

Id. at *2 (quoting Haag v. Shulman, 683 F.3d 26, 32 n.2 (1st Cir.2012)). By contrast, in *Cutler v. Commissioner*, T.C. Memo. 2013-119, 2013 Tax Ct. Memo LEXIS 121, the IRS moved past a timeliness question to determine the matter on the merits, apparently because of Notice 2011-70. *See id.* at *6, *10 n.13.

The IRS subsequently issued Chief Counsel Notice 2012-8, 2012-4 I.R.B. 309, to announce a proposed Revenue Procedure regarding section 6015(f) claims, as discussed above in Section 17.02[A][3]. As discussed at the beginning of this Section, the proposed Revenue Procedure has been finalized as Revenue Procedure 2013-34, which contains the new, context-sensitive period of limitation.

§ 17.02[B][2] (Court Jurisdiction Over Innocent Spouse Claims)

In *Kollar v. Commissioner*, 131 T.C. 191 (2008), the Tax Court explained that Congress had amended former section 6015(e)(1) to clarify that the Court has jurisdiction to decide a non-deficiency section 6015(f) case involving the taxpayer's "liability for *taxes* arising or remaining unpaid on or after" December 20, 2006. *Id.* at 193–94 (emphasis added). Mrs. Kollar's petition for relief involved only accrued interest. *Id.* at 192.

Because the word "taxes" is not defined, and it was thus not clear whether it included interest, the court gave the word the meaning "best gleaned from Congress's understanding of the firmly established meaning of that word as used in the Code . . . when TRHCA was enacted." *Id.* at 194. Congress had provided in other Code sections that "tax" for purposes of the Code included interest and penalties. *Id.* at 195. "In addition, Congress had provided in section 6015(b)(1) that the word 'tax' included 'interest, penalties, and other amounts.'" *Id*. The court could find no reason why a narrower definition would apply in the context in question, so it held that "taxes" included accrued interest and that it therefore had jurisdiction over the matter under section 6015(e)(1). *Id.* at 196–97.

In *Pollock v. Commissioner*, 132 T.C. 21 (2009), the Tax Court held that section 6015(e)(1)(A)'s 90-day limit to file a "stand-alone" innocent spouse petition is jurisdictional and therefore does not allow for equitable tolling. The court found that although it has the power to apply equitable principles to decide a case over which it has jurisdiction, it cannot use equitable principles to expand the court's jurisdiction where it would otherwise not have it. *Id.* at 33. Thus, the Tax Court dismissed Pollock's claim for lack of jurisdiction. *Id.* at 37. For a critique of the *Pollock* decision, see Carlton M. Smith, *Equitably Tolling Innocent Spouse and Collection Due Process Periods*, 126 TAX NOTES 1106 (2010).

What happens if the Commissioner changes his position regarding a grant or denial of spousal relief? In *Nunez v. Commissioner*, 599 F. App'x 629, 630 (9th Cir. 2015), the court considered the Tax Court's jurisdiction under section 6015 in cases in which the Commissioner changes position and stops opposing the requesting spouse's request for relief. The court stated:

> [E]ven if the Tax Court were fully bound by Article III constraints, the Commissioner's communication of his position that "petitioner is entitled to equitable relief under I.R.C. § 6015(f)" did not moot the case, as the Commissioner did not grant the requested relief. A respondent's failure to defend its decision on appeal, without some action that moots or vacates the decision, does not ordinarily deprive an appellate court of a live case or controversy. And here, because the Commissioner never revoked, or promised to revoke, the notice of final determination denying Nunez's request for § 6015(f) relief, Nunez continued to experience an injury that the Tax Court would have been able to redress, even though the Tax Court ultimately did deny her petition. . . . We therefore conclude that the Tax Court did not err in denying Nunez's motion to vacate.

Id. at 630–31 (footnote omitted).

§ 17.02[B][3][b] (Intervention in a Tax Court Proceeding)

For an interesting empirical comparison of the outcomes of cases in which the other spouse does or does not intervene, see Jonathan T. Trexler, *Contesting Innocent Spouse Relief: the Intervention Paradox*, 126 TAX NOTES 499 (2010). He concludes, in part:

> Taxpayers claiming innocent spouse relief in court have succeeded in 28 percent of cases decided on the merits, or 25 percent of those cases when culpable spouses do not intervene. But the rate of success jumps to 49 percent when opposed by culpable spouses (or 33 percent if one excludes cases in which the Service is willing to settle but the culpable spouse objects). Under the circumstances, it is difficult to tell the client that the Tax Court will give weight to his testimony and argument if he accepts the invitation to participate. Quite the opposite, his involvement could create an outlet for the judge's annoyance at an unpaid tax delinquency. In other words, the court would have an alternative participant on whom it can comfortably focus blame, increasing the taxpayer's chance of winning innocent spouse relief.

Id. at 504.

§ 17.02[B][5] (Res Judicata)

In *Deihl v. Commissioner*, 134 T.C. 156 (2010), the Tax Court addressed the scope of the res judicata provision in section 6015(g)(2). In that case, Mr. and Ms. Diehl had litigated three cases before the Tax Court, relating to tax years 1996 through 1998. *Id.* at 157. In one of the cases, the petition included a claim for innocent spouse relief, stating:

> Under Sec. 6013(e) and 6015, PETITIONER SARI F. DEIHL was/is an innocent spouse for the year at issue in the statutory NOD. Considering all of the facts and circumstances, it would be unfair to hold SARI responsible for the understatement of tax, if any, and related penalties and interest, if any.

Id. at 158. However, paragraph 20 of the parties' stipulation of facts stated that Ms. Diehl no longer sought innocent spouse relief for any of the three years. *Id.*

Mr. Diehl passed away during the course of the litigation. *Id*. Subsequently, Ms. Diehl filed Form 8857, requesting relief under section 6015(b), (c), and (f) for all three of the previously litigated tax years. *Id.* at 159. The IRS argued that section 6015(g)(2) barred her claim. *Id*. The court disagreed:

> [T]he issue of relief from joint and several liability [was raised] in the 1996 petition. Although paragraph 20 seemingly withdraws the issue for all years in the consolidated cases, the petitions and corresponding answers filed for 1997 and 1998 did not raise relief from joint and several liability. Further, respondent's pretrial memorandum for the consolidated cases specifically addressed petitioner's claim with respect to 1996 only. *Because relief from joint and several liability was raised in the pleadings for 1996 only, that is the only year in which said relief was an issue*. See Rules 38, 324. Relief from joint and several liability was not an issue in 1997 or 1998. The mere reference to 1997 and 1998 in paragraph 20 without more did not put relief from joint and several liability in issue for those years. Accordingly, petitioner is not barred from making an election under section 6015(b) and (c) and requesting equitable relief under section 6015(f) for 1997 and 1998.
>
> The 1996 petition did not specify the basis for relief requested under section 6015; i.e., whether petitioner was electing or requesting relief under section 6015(b), (c), or (f). However, petitioner was not eligible to make an election under section 6015(c) when the 1996 petition was filed because she was not divorced or separated from Mr. Diehl. Determining what subsections of section 6015 were an issue in a prior proceeding under these facts is an issue of first impression. *We hold that for purposes of section 6015(g)(2), an election under section 6015(c) shall not be deemed to have been an issue in a prior*

> *proceeding where the requesting spouse's original request for relief under section 6015 did not specifically invoke section 6015(c) and the requesting spouse was ineligible to make an election under section 6015(c) at the time because the requesting spouse's husband was alive*. Therefore, we conclude that petitioner's claim for innocent spouse relief in the 1996 petition was an election under section 6015(b) and a request for equitable relief under section 6015(f). Relief under section 6015(c) for 1996 was not an issue in the consolidated cases.

Id. at 165–66 (emphasis added). Accordingly, section 6015(g) did not bar Ms. Diehl from seeking innocent spouse relief under section 6015(c). *Id.* at 167.

The more recent case of *Harbin v. Commissioner*, 137 T.C. 93 (2011), involves the interaction of an attorney's conflict of interest with the res judicata provision. In that case, the IRS had pursued tax deficiencies related in part to the gambling activities of Mr. Harbin's then-wife. *Id.* at 94–95. The taxpayers and the IRS executed a stipulated decision in that case. *Id.* The taxpayers shared a single attorney for both the deficiency litigation and their divorce proceedings. *Id.* The Tax Court explained:

> While the prior deficiency case was going forward, Mr. Caldwell also represented petitioner and intervenor [Mr. Harbin's then-wife] in their contentious divorce. . . . until the divorce was finalized shortly before trial in the prior deficiency case. Petitioner's and intervenor's financial interests and interests in the allocation of liability for the deficiencies at issue were adverse in the prior deficiency case. Mr. Caldwell's joint representation of petitioner and intervenor in the prior deficiency case created a conflict of interest.
>
> Mr. Caldwell did not explain the advantages and risks of joint representation to petitioner. Mr. Caldwell failed to disclose the conflict of interest to petitioner. He never asked petitioner to waive the conflict of interest, and petitioner never did.

Id.

When the IRS applied an overpayment from a later tax year to the joint tax deficiency, Mr. Harbin requested innocent spouse relief. *Id*. The IRS argued that res judicata barred relief but the court held otherwise. *See id.* at 97. The court found both that relief from joint and several liability was not an issue in the deficiency proceeding and that Mr. Harbin did not meaningfully participate in that proceeding. *Id.* at 98–99. The court explained its decision on the "meaningful participation" issue as follows:

> Petitioner did not have a high level of participation in the prior deficiency case. Petitioner was over 60 years old and was retired at the time of the prior deficiency case. He participated in the prior deficiency case through Mr. Caldwell's representation. . . .

> Petitioner's opportunity to raise a claim for relief from joint and several liability in the prior deficiency case was obscured and obstructed by Mr. Caldwell's continued concurrent representation of petitioner and intervenor, whose interests were adverse. . . .
>
> Mr. Caldwell's joint representation of petitioner and intervenor involved an actual conflict of interest. Petitioner had a viable claim for relief from joint and several liability under section 6015(b) with respect to the deficiencies at issue . . . during the prior deficiency case. Petitioner's claim was directly adverse to the interest of intervenor, who was contesting the deficiencies at issue.
>
> Mr. Caldwell never obtained informed written consent waiving the conflict of interest, as required under this Court's Rules. See Rule 24(g). Moreover, Mr. Caldwell did not disclose the conflict of interest to petitioner. Instead, he proceeded with the representation despite the conflict of interest. We believe this materially limited Mr. Caldwell's ability to represent petitioner's interest in bringing a claim for relief from joint and several liability.
>
> Finally, petitioner was not informed of his opportunity to and consequently did not raise a claim for relief from joint and several liability in the prior deficiency case.

Id. at 99.

PROBLEMS

There is a typo in the last paragraph of the answer to Problem 5B on page 396 of the Teacher's Manual. The computed result should be $1,000 more than is stated in that paragraph.

Chapter 18

§ 18.03[B][1] (Background and Scope)

In 2010, the IRS announced efforts to increase oversight and regulation of previously unregulated tax return preparers. The initiatives included: (1) requiring paid preparers to register and obtain a preparer tax identification number (PTIN) and record that PTIN on all returns they prepare; and (2) mandating competency testing and continuing education for all paid return preparers except those already governed by Circular 230 (attorneys, CPAs, and enrolled agents). The initiatives subjected these previously unregulated preparers to the standards in Circular 230. By doing so, the Office of Professional Responsibility (OPR) estimated that its jurisdiction would have expanded by around 1 million paid return preparers. *See* John C. Gardner et al., *2010-2011 Revisions to Circular 230*, 43 TAX ADVISER 42 (2012) (reporting that the IRS had received over 745,000 PTIN applications by November, 2011).

In 2011, the Treasury Department finalized revisions to Circular 230 that incorporated some of the initiatives. The new rules created a new class of practitioner called "registered tax return preparers." *See*, *e.g.*, 31 C.F.R. § 10.02(a)(8) (expanding the scope of Circular 230 to all tax return preparers), § 10.03(f) (creating the registered tax return preparer designation), § 10.04(c) (competency testing requirement). The revisions also maintained that return preparation constitutes "practice before the Internal Revenue Service" within the meaning of Circular 230. 31 C.F.R. § 10.2(a)(4).

Response from the practitioner community to the IRS's effort to expand regulation of tax practitioners was mostly negative. *See*, *e.g.*, Jeremiah Coder, *Education Requirements Questioned at Circular 230 Hearing*, 129 TAX NOTES 287 (2010) (recounting reactions of commentators who questioned the need for continuing education and IRS's ability to create appropriate testing requirements); Jeremiah Coder & Nicole Duarte, *New PTIN in Place After IRS Finalizes Regulations*, 129 TAX NOTES 12 (2010) (recounting questioning by commentators of what they viewed as an expansive definition of who must register as a tax return preparer).

Several return preparers filed a lawsuit challenging the IRS's authority to require preparers to obtain a PTIN and to implement the new oversight measures. Loving v. I.R.S., 917 F. Supp. 2d 67 (D.D.C. No. 1:12-cv-00385) (Mar. 13, 2012). In 2013, the District Court for the District of Columbia heard the *Loving* case and struck down the IRS's registered tax return preparer (RTRP) program, enjoining the IRS from promulgating rules regulating the qualifications of unlicensed return preparers. Loving v. I.R.S., 917 F. Supp. 2d 67 (D.D.C. 2013). The D.C. Circuit Court of Appeals affirmed the District Court's ruling that the Treasury Department exceeded its authority when it expanded Circular 230 to cover all RTRPs. Loving v. I.R.S., 742 F.3d 1013, 1022 (D.C. Cir. 2014).

The question before the court was whether a practitioner whose only contact with the IRS is preparing tax returns for a client could be regulated by the Treasury Department. *Id.* at 1016.

Applying canons of statutory construction to regulations issued under 31 U.S.C. section 330, which gives the Treasury Department the authority to regulate the "practice of representatives" before the IRS, the Court of Appeals concluded that the language of section 330 was unambiguous and return preparers are not "representatives" who "practice" before the IRS. *Id.* at 1017. According to the court:

> In our judgment, the traditional tools of statutory interpretation — including the statute's text, history, structure, and context — foreclose and render unreasonable the IRS's interpretation of Section 330. Put in *Chevron* parlance, the IRS's interpretation fails at *Chevron* step 1 because it is foreclosed by the statute. In any event, the IRS's interpretation would also fail at *Chevron* step 2 because it is unreasonable in light of the statute's text, history, structure, and context. It might be that allowing the IRS to regulate tax-return preparers more stringently would be wise as a policy matter. But that is a decision for Congress and the President to make if they wish by enacting new legislation.

Id. at 1021–22. The Treasury Department has announced that it would not appeal the ruling. Andrew Velarde & Jamie Arora, *U.S. Won't Take* Loving *Decision to Supreme Court*, 143 TAX NOTES 771 (2014).

Relying heavily upon the principles laid out in *Loving*, the U.S. District Court for the District of Columbia ruled that the IRS may not prohibit the use of contingent fees in refund claims because the IRS lacks the authority under Circular 230 to regulate the preparation and filing of refund claims. Ridgely v. Lew, 55 Fed. Supp. 3d 89 (D.D.C. 2014). For a discussion of *Loving* and *Ridgely*, see Steve R. Johnson, *How Far Does Circular 230 Exceed Treasury's Statutory Authority?*, 146 TAX NOTES 221, 240 (2015) ("If the approach of recent cases is confirmed by future litigation and Congress chooses not to act, significant portions of Circular 230 may be at risk of invalidation.").

Analysis of and debate over *Loving* have been extensive. *See, e.g.*, William D. Elliot, *Selected Issues from the 2013 National Taxpayer Advocate Report*, TAXES, May 2014, at 11, 13 (noting that the "problem associated with unregulated tax return preparers is huge"); Joint Committee on Taxation, Present Law and Background Related to the Regulation of Conduct of Paid Tax Return Preparers (JCX-34-14), April 4, 2014 [hereinafter 2014 Joint Committee Report] (noting that the plaintiffs in *Loving* did not object to the IRS regulating paid return preparers who represent taxpayers during examination); Richard M. Lipton, *"Tough* Loving*": District Court Invalidates IRS Regulation of Return Preparers*, 118 J. TAX'N 200 (Apr. 2013) (noting that *Loving* does not affect the application of Circular 230 to lawyers, CPAs, or enrolled agents); Matthew R. Madara, *Appeals Court Affirms* Loving, *Disallowing Preparer Requirements*, 143 TAX NOTES 701 (2014) (quoting representative from the Institute for Justice who described the decision as a "big victory for not just independent tax preparers but also taxpayers"); Donald T. Williamson & James S. Gale, Loving *and the End of RTRPs*, 143 TAX

NOTES 366 (2014) (noting that the decision "makes clear that the judiciary will not permit the IRS (or other agencies) to accomplish desirable goals through regulatory fiat without legislative authority").

Shortly after the Court of Appeals decision in *Loving*, several lawmakers introduced legislation in the House of Representatives that would expand the definitional provisions in the authorizing statute to include return preparers. *See* Tax Return Preparer Accountability Act of 2014, H.R. 4470. Similar legislation has also been introduced in the Senate. *See* Taxpayer Protection and Preparer Proficiency Act of 2015, S. 137. A number of states have begun to set minimum standards of conduct for tax preparers. Among those is New York, which adopted its standards in December of 2013. *See* N.Y. Dep't of Taxation & Fin., Fact Sheet: New York's First Tax Preparer Regulations, Tax.Ny.Gov (Dec 11, 2013), *available at* https://www.tax.ny.gov/tp/reg/fact_sheet.pdf.

In addition, the IRS has announced a "voluntary" program to regulate tax return preparers called the Annual Filing Season Program. Return preparers who complete the required amount of continuing education will have their names and contact information included on a public database. *See* Revenue Procedure 2014-42, 2014-42 I.R.B. 192. The online directory, first released in 2015, lists the names of individuals with PTINs but does not include contact information. The directory is searchable by location and by preferred qualifications (attorney, CPA, enrolled agent, or participant in the Annual Filing Season Program). *See* Directory of Federal Tax Return Preparers with Credentials and Select Qualifications, *available at* http://irs.treasury.gov/rpo/rpo.jsf.

Reactions to the new program from policymakers and practitioners have been mixed. *See* David van der Berg, *IRS Announces Voluntary Preparer Certification Regime*, 143 TAX NOTES 1475 (2014) (reporting National Taxpayer Advocate's concerns about the lack of any competency testing); William Hoffman, *Return Preparers Anxious as IRS Prepares Voluntary Certification*, 143 TAX NOTES 1367 (2014) (citing letter from the American Institute of Certified Public Accountants (AICPA) that describes the program as "arbitrary and capricious" and without any statutory basis). The AICPA filed a lawsuit in the U.S. District Court for the District of Columbia to block the IRS from proceeding with the program. *See* Am. Inst. of Certified Pub. Accountants v. IRS, D.D.C. No. 1:14-cv-01190 (Sept. 3, 2014). The lawsuit maintained that the proposed program requires the IRS to comply with notice-and-comment procedures under the Administrative Procedure Act, which the IRS had not satisfied. The court granted the IRS's motion to dismiss the lawsuit after concluding that the AICPA did not have standing to bring the suit because it could not show that its members would be injured by the voluntary program. *See* Am. Inst. of Certified Pub. Accountants, D.D.C. No. 1:14-cv-01190 (Oct. 27, 214). The AICPA has appealed the District Court's dismissal. Diane Freda, *AICPA Appeals District Court's Ruling on IRS Voluntary Tax Preparer Program*, DAILY TAX REP. (BNA), Apr. 10, 2015, at K-1.

The imposition of an annual fee for a PTIN has proven controversial. Just before *Loving* was decided by the District Court, the Eleventh Circuit affirmed a lower court ruling that dismissed a challenge to such a fee. Jesse E. Brannen III PC v. United States, 682 F.3d 1316 (11th Cir.), *cert. denied*, 133 S. Ct. 587 (2012). The court found that the annual user fee did not exceed the Treasury Department's statutory authority. *Id.* In a recent report, the Joint Committee on Taxation maintains that while *Loving* enjoins the IRS from requiring attendance or collecting fees with respect to its previous testing and education programs, the IRS's PTIN program, which requires return preparers to obtain a PTIN, register with the IRS, and pay a required user fee, remains in effect. *See* 2014 Joint Committee Report, *supra*. Nonetheless, a class action lawsuit has been filed on behalf of 700,000 tax preparers seeking to prevent the IRS from charging user fees to obtain or renew a PTIN. Steele v. United States, D.D.C., No. 1:14-cv-01523. The lawsuit maintains that a portion of the user fee is charged for services such as compliance checks and issuing registration cards that the IRS has not provided and is therefore unlawful. Diane Freda, *Preparer Lawsuits Over PITNs Latest Challenge to IRS Registration Program*, DAILY TAX REP. (BNA), Sept. 10, 2014, at K-3.

The OPR has posted on its website sanction guidelines for violations of Circular 230. *See Office of Professional Responsibility Guide to Sanctions, available at* http://www.irs.gov/pub/irs-utl/newly_revised_final_tax-non_compliance_sanction_guidelines_3.pdf. According to the guidelines, all relevant factors must be considered when determining the appropriate sanction. *Id.* at 1. The guidelines include lists of mitigating and aggravating factors the OPR will consider:

MITIGATING FACTORS

1. For tax non-compliance cases, correction of the violation before contact with the IRS.
2. For tax non-compliance cases, correction of the violation before contact with OPR.
3. For tax non-compliance cases, correction initiated within a reasonably short period after contact by OPR.
4. Illness, incapacitation, or personal hardships directly correlating to the action or inaction violating Circular 230.
5. Illness, incapacitation or personal hardships of the family or others close to the practitioner directly correlating to the action or inaction violating Circular 230.
6. Personal or professional financial distress correlating to non-payment of taxes, but not non-payment of form 941 employment tax obligations.
7. Extrinsic circumstances such as natural disasters directly correlating to the action or inaction violating Circular 230.
8. Recognition of action or inaction violating Circular 230 and commitment to future compliance.
9. For firms, commitment to establishing internal controls to prevent recurrences of the violation.

10. Preventative measures in effect prior to the misconduct/and or measures put into place after the misconduct to prevent future violations.
11. Age of allegations.

AGGRAVATING FACTORS

1. Failure to respond to OPR contact.
2. For tax non-compliance cases, failure to correct the issue after contact from the IRS.
3. For tax non-compliance cases, failure to correct after contact by OPR.
4. For tax non-compliance cases, multiple tax issues related to noncompliance on multiple types of forms in the same tax period, including penalties.
5. For tax non-compliance cases, sum of money at issue.
6. Motive, especially those indicating personal gain.
7. Pattern of action or inaction violating Circular 230.
8. Assertion of legal arguments previously ruled frivolous by courts of law.
9. Confrontational behavior outside the bounds of zealous defense.
10. Previous incidents of violation of Circular 230.
11. The number of offenses.
12. Failure to understand or recognize that actions constituted a violation of Circular 230.
13. Negative effect on tax administration.

Id. at 3. The guidelines also include a penalty grid with suggested suspension ranges for practitioners who do not file a return or file it late. Recently, the IRS announced its first monetary sanction against a firm under Circular 230. Jaime Arora & Andrew Velarde, *OPR Announces First Monetary Sanction*, 143 TAX NOTES 793 (2014).

§ 18.03[B][2] (Advising Tax Positions and Preparing Returns)

As explained on pages 709–10 of the text, when Congress revised the section 6694 return preparer penalty in 2007 to increase the reporting standard for undisclosed positions to a more-likely-than-not standard, the Treasury made conforming amendments to section 10.34 of Treasury Circular 230. The Treasury's initial response to the 2008 amendments to section 6694 (explained above in connection with Section 12.03), which lowered the standard for undisclosed positions to a substantial authority standard, was to withdraw its earlier changes to section 10.34 and reserve for future guidance those portions relating to the expected standards of conduct applicable to practitioners who provide return advice. Since that time, the Treasury has revised the section 10.34(a) standards governing the preparation of tax returns. The current revisions provide:

(a) *Tax returns.*—

(1) A practitioner may not willfully, recklessly, or through gross incompetence—

(i) Sign a tax return or claim for refund that the practitioner knows or reasonably should know contains a position that—

(A) Lacks a reasonable basis;

(B) Is an unreasonable position as described in section 6694(a)(2) of the Internal Revenue Code (Code) (including the related regulations and other published guidance); or

(C) Is a willful attempt by the practitioner to understate the liability for tax or a reckless or intentional disregard of rules or regulations by the practitioner as described in section 6694(b)(2) of the Code (including the related regulations and other published guidance).

(ii) Advise a client to take a position on a tax return or claim for refund, or prepare a portion of a tax return or claim for refund containing a position, that—

(A) Lacks a reasonable basis;

(B) Is an unreasonable position as described in section 6694(a)(2) of the Code (including the related regulations and other published guidance); or

(C) Is a willful attempt by the practitioner to understate the liability for tax or a reckless or intentional disregard of rules or regulations by the practitioner as described in section 6694(b)(2) of the Code (including the related regulations and other published guidance).

(2) A pattern of conduct is a factor that will be taken into account in determining whether a practitioner acted willfully, recklessly, or through gross incompetence.

31 C.F.R. § 10.34(a) (effective August 2, 2011).

Revised section 10.34 creates a minimum standard of conduct that is consistent with the section 6694 return preparer penalty standards, although some differences exist. For example, the section 10.34(a) revisions provide that a position on a tax return or refund claim must always meet a minimum reasonable basis standard. The Circular 230 standards, unlike section 6694, do not incorporate a reasonable cause defense. However, the standards of “willful, reckless or grossly incompetent” would seem to protect a practitioner from sanction if the practitioner acted reasonably and in good faith. Finally, unlike section 6694, the Circular 230 revisions permit the Treasury Department to impose sanctions even if no tax understatement exists. The preamble to the Circular 230 revisions points out that a violation of the return preparer penalty standards in section 6694 does not result in an automatic violation of the standards in section 10.34(a). *See* T.D. 9527, 2011-2 C.B. 1.

§ 18.03[C] (Return Preparer Penalties)

As explained above in connection with Section 12.03, 2008 amendments to the return preparer penalty in section 6694 align, for the most part, the return preparer standard with the accuracy-related penalty standard that applies at the taxpayer level. The conflict of interest issues created by the more-likely-than-not standard, which are mentioned in the text, have therefore largely been resolved by the 2008 amendments to section 6694. The section 6694 standard for undisclosed positions, however, remains higher than the realistic-possibility-of-success standard expressed in ABA Formal Opinion 85-352.

§ 18.04 (TAX SHELTER TRANSACTIONS AND TAX OPINION LETTERS)

The 2008 amendments to the return preparer penalty in section 6694, discussed in connection with Section 12.03 above, particularly section 6694(a)(2)(C), which retains the more-likely-than-not standard for tax shelter-type transactions, affect some of the discussion in Section 18.04. Prior to its recent amendment, Circular 230 section 10.35 contained standards that were largely consistent with the standard in section 6694(a)(2)(C). As explained below, the standards in section 10.35 for written advice have been revised and are now less specific and no longer contain a more-likely-than-not standard.

The revisions to section 10.35 of Circular 230, originally proposed in 2012, were finalized by the Treasury Department in June of 2014. *See* T.D. 9668, 2014-27 I.R.B. (June 30, 2014), *available at* http://www.irs.gov/irb/2014-27_IRB/ar07.html. The revisions remove the covered opinion standards in section 10.35 and replace them with a single standard for written advice in revised section 10.37. The preamble to the proposed regulations explains the thinking behind the revisions and explains proposed changes to section 10.37:

> A. Elimination of Covered Opinion Rules in § 10.35
>
> Current §§ 10.35 and 10.37 provide comprehensive rules with respect to written tax advice. Specifically, current § 10.35 provides detailed rules for tax opinions that constitute "covered opinions" under Circular 230. Covered opinions include written advice concerning: (1) A listed transaction; (2) a transaction with the principal purpose of tax avoidance or evasion; or (3) a transaction with a significant purpose of tax avoidance or evasion, if the advice is a reliance opinion, marketed opinion, subject to conditions of confidentiality, or subject to a contractual protection.
>
> The definitions of the various types of covered opinions under Circular 230 require considerable effort on behalf of practitioners to determine whether the advice rendered in a particular circumstance is subject to the covered opinion

rules in current § 10.35. Because of the effort involved, many practitioners attempt to exempt the advice from the covered opinion rules by making a prominent disclosure or disclaimer stating that the opinion cannot be relied upon for penalty protection, as permitted by Circular 230.

Circular 230 also requires that practitioners comply with the extensive requirements set forth in § 10.35 when providing written advice that constitutes a covered opinion. Many of the standards in current § 10.35 track principles a competent practitioner uses when considering and rendering any advice, although these standards may be more rigid and cumbersome in application than generally applicable ethical standards. For example, current § 10.35 requires the practitioner to include in the written advice the relevant facts (including assumptions and representations), the application of the law to those facts, and the practitioner's conclusion with respect to the law and the facts. This mechanical requirement of automatic inclusion of information will sometimes lead to awkward or unnecessary, highly technical discussions in the opinion that may hinder the practitioner's ability to provide quality tax advice. Further, the inclusion of this particular detail almost always burdens the practitioner and the client with significant increased costs, without necessarily increasing the quality of the tax advice that the client receives.

Significant progress has been made in combating abusive tax shelters and schemes, and preventing unscrupulous individuals from promoting those arrangements. In recent years, heightened awareness of the ethical standards governing tax advice contributed to this improved state and has benefitted practitioners, taxpayers, and the government. At the same time, there is no direct evidence to suggest that the overly-technical and detailed requirements of current § 10.35 were responsible for, or particularly effective at, curtailing the behavior of individuals attempting to profit from promoting frivolous transactions or transactions without a reasonable basis.

For these reasons, the proposed regulations eliminate the covered opinion rules in § 10.35 and instead subject all written tax advice to streamlined standards under proposed § 10.37, as described later in this preamble. . . .

The elimination of the covered opinion rules in this notice of proposed rulemaking would, at a minimum, save tax practitioners $5,333,200. This burden reduction comes from the elimination of the provisions requiring practitioners to make certain disclosures in the covered opinion.

This number does not include a number of other significant savings to both tax practitioners and taxpayers relating to the cost of obtaining a covered opinion under the current rules that would occur as a result of the proposed regulations. Practitioners spend many hours each year determining whether they need to prepare a covered opinion for a client or if the advice falls into one of the exceptions. This requires significant time to, among other things, research and review the complicated covered opinion rules and discuss the issue with other practitioners in the firm to determine the right course of action. If the practitioner decides, after undertaking these activities, that a covered opinion is necessary, the practitioner must discuss the covered opinion rules with the client, including how the rules affect the scope of the work that the client has asked the practitioner to perform, because the client will incur significant extra costs to obtain the written advice the client requested. These significant extra costs can, in some cases, tip the scales against obtaining written advice.

B. Revision of Requirements for Written Advice

Treasury and the IRS continue to be aware of the risk associated with practitioners providing and marketing written tax opinions. Proposed § 10.37, therefore, replaces the covered opinion rules with basic principles to which all practitioners must adhere when rendering written advice. The proposed provisions also complement the best practices of § 10.33 and the due diligence requirements in § 10.22. Specifically, the proposed regulations revise § 10.37 to state affirmatively the standards to which a practitioner must adhere when providing written advice on a Federal tax matter. Proposed § 10.37 requires, among other things, that the practitioner base all written advice on reasonable factual and legal assumptions, exercise reasonable reliance, and consider all relevant facts that the practitioner knows or should know. A practitioner must also use reasonable efforts to identify and ascertain the facts relevant to written advice on a Federal tax matter under the proposed regulations.

Consistent with current § 10.37, the proposed regulations provide that a practitioner must not, in evaluating a Federal tax matter, take into account the possibility that a tax return will not be audited or that an issue will not be raised on audit. Proposed § 10.37 eliminates the provision in the current regulations that prohibits a practitioner from taking into account the possibility that an issue will be resolved through settlement if raised when giving written advice evaluating a Federal tax matter. Treasury and IRS conclude that the current rule may unduly restrict the ability of a practitioner to provide comprehensive written advice because the existence or nonexistence of legitimate hazards that may make settlement more or less likely may be a material issue for which the practitioner has an obligation to inform the client.

Under proposed § 10.37(c)(2), the IRS will continue to apply a heightened standard of review to determine whether a practitioner has satisfied the written advice standards when the practitioner knows or has reason to know that the written advice will be used in promoting, marketing, or recommending an investment plan or arrangement a significant purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code.

Proposed § 10.37(b) also provides that a practitioner may rely on the advice of another practitioner only if the reliance on that advice is reasonable and in good faith considering the facts and circumstances. Specifically, proposed § 10.37(b) provides that reliance is not reasonable when the practitioner knows or should know that the opinion of the other practitioner should not be relied on, the other practitioner is not competent to provide the advice, or the other practitioner has a conflict of interest. These proposed reliance provisions incorporate reliance concepts from current §§ 10.22 and 10.35(d). Proposed § 10.37, unlike current § 10.35, does not require that the practitioner describe in the written advice the relevant facts (including assumptions and representations), the application of the law to those facts, and the practitioner's conclusion with respect to the law and the facts. Rather, the scope of the engagement and the type and specificity of the advice sought by the client, in addition to all other appropriate facts and circumstances, are factors in determining the extent that the relevant facts, application of the law to those facts, and the practitioner's conclusion with respect to the law and the facts must be set forth in the written advice. Also, under proposed § 10.37, unlike current § 10.35, the practitioner may consider these factors in determining the scope of the written advice. Further, the determination of whether a practitioner has failed to comply with the requirements of proposed § 10.37 will be based on all facts and circumstances, not on whether each requirement is addressed in the written advice.

As discussed earlier in this preamble, many practitioners currently use a Circular 230 disclaimer at the conclusion of every email or other writing as a measure to remove the advice from the covered opinion rules in § 10.35. In many instances, these disclaimers are frequently inserted without regard to whether the disclaimer is necessary or appropriate. These types of disclaimers are routinely inserted in any written transmission, including writings that do not contain any tax advice. The proposed removal of current § 10.35 eliminates the detailed provisions concerning covered opinions and disclosures in written opinions. Because proposed § 10.37 does not include the disclosure provisions in the current covered opinion rules, Treasury and the IRS expect that these amendments, if adopted, will eliminate the use of a Circular 230 disclaimer in email and other writings.

Overall, Treasury and the IRS have determined that the proposed regulations regarding written advice strike an appropriate balance between allowing practitioners flexibility in providing written advice and at the same time maintaining standards that require the practitioner to act ethically and competently. Treasury and the IRS are particularly interested in comments responding to whether the proposed rules achieve that appropriate balance.

Regulations Governing Practice Before the Internal Revenue Service, 77 Fed. Reg. 57,055 (Sept. 17, 2012).

The texts of revised sections 10.35 and 10.37 are as follows:

§ 10.35 Competence.

(a) A practitioner must possess the necessary competence to engage in practice before the Internal Revenue Service. Competent practice requires the appropriate level of knowledge, skill, thoroughness, and preparation necessary for the matter for which the practitioner is engaged. A practitioner may become competent for the matter for which the practitioner has been engaged through various methods, such as consulting with experts in the relevant area or studying the relevant law.

(b) *Effective/applicability date*. This section is applicable beginning June12, 2014.

§ 10.37 Requirements for written advice.

(a) *Requirements.* (1) A practitioner may give written advice (including by means of electronic communication) concerning one or more Federal tax matters subject to the requirements in paragraph (a)(2) of this section. . . .

(2) The practitioner must—

(i) Base the written advice on reasonable factual and legal assumptions (including assumptions as to future events);

(ii) Reasonably consider all relevant facts and circumstances that the practitioner knows or reasonably should know;

(iii) Use reasonable efforts to identify and ascertain the facts relevant to written advice on each Federal tax matter;

(iv) Not rely upon representations, statements, findings, or agreements (including projections, financial forecasts, or appraisals) of the taxpayer or any other person if reliance on them would be unreasonable;

(v) Relate applicable law and authorities to facts; and

(vi) Not, in evaluating a Federal tax matter, take into account the possibility that a tax return will not be audited or that a matter will not be raised on audit.

(3) Reliance on representations, statements, findings, or agreements is unreasonable if the practitioner knows or reasonably should know that one or more representations or assumptions on which any representation is based are incorrect, incomplete, or inconsistent.

(b) *Reliance on advice of others*. A practitioner may only rely on the advice of another person if the advice was reasonable and the reliance is in good faith considering all the facts and circumstances. Reliance is not reasonable when—

(1) The practitioner knows or reasonably should know that the opinion of the other person should not be relied on;

(2) The practitioner knows or reasonably should know that the other person is not competent or lacks the necessary qualifications to provide the advice; or

(3) The practitioner knows or reasonably should know that the other person has a conflict of interest in violation of the rules described in this part.

(c) *Standard of review*. (1) In evaluating whether a practitioner giving written advice concerning one or more Federal tax matters complied with the requirements of this section, the Commissioner, or delegate, will apply a reasonable practitioner standard, considering all facts and circumstances, including, but not limited to, the scope of the engagement and the type and specificity of the advice sought by the client.

(2) In the case of an opinion the practitioner knows or has reason to know will be used or referred to by a person other than the practitioner (or a person who is a member of, associated with, or employed by the practitioner's firm) in promoting, marketing, or recommending to one or more taxpayers a partnership or other entity, investment plan or arrangement a significant purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code, the Commissioner, or delegate, will apply a reasonable practitioner standard, considering all facts and circumstances, with emphasis given to the additional risk caused by the practitioner's lack of knowledge of the taxpayer's particular circumstances, when determining whether a practitioner has failed to comply with this section.

(d) *Federal tax matter*. A Federal tax matter, as used in this section, is any matter concerning the application or interpretation of—

(1) A revenue provision as defined in section 6110(i)(1)(B) of the Internal Revenue Code;

(2) Any provision of law impacting a person's obligations under the internal revenue laws and regulations, including but not limited to the person's liability to pay tax or obligation to file returns; or

(3) Any other law or regulation administered by the Internal Revenue Service.

(e) *Effective/applicability date*. This section is applicable to written advice rendered after June 12, 2014.

Do the new standards address the concerns expressed in Professor Schenk's article, excerpted in the text on pages 720–25?

The move away from specific rules to a more principles-based approach to the regulation of written advice has drawn praise from commentators. *See, e.g.*, Richard M. Lipton, *Proposed Regulations Radically Overhaul "Tax Opinion" and Other Rules in Circular 230*, 118 J. TAX'N 6 (Jan. 2013); Matthew R. Madara, *Final Circular 230 Regs Eliminate Covered Opinion Rules*, 143 TAX NOTES 1234 (June 16, 2014); Joseph DiSciullo, *NYSBA Tax Section Endorses Most Proposed Circular 230 Amendments*, 139 TAX NOTES 81 (2013). *But see Competence Standard of IRS Circular 230 Proposed Rules Draws Concerns, Groups Says*, DAILY TAX REP. (BNA), Dec. 17, 2012, at G-4 (expressing concerns that references to "thoroughness" and "preparation" could be "interpreted to mean that a practitioner should not advise a client who has an imminent deadline unless the practitioner is able to thoroughly prepare for the presentation"). In light of the new regulations, the IRS Office of Professional Responsibility maintains that practitioners should stop using Circular 230 disclaimers in their correspondence. *See* William R. Davis, *OPR Will Tell Practitioners to Remove Circular 230 Disclaimers*, 143 TAX NOTES 1360 (June 23, 2014). One article expressed concern that, having utilized boilerplate Circular 230 email disclosure statements for so many years, eliminating those disclosures might confuse clients. Sheldon I. Banoff & Richard M. Lipton, *Should You Disclose Your Nondisclosure of the Circular 230 Disclosure?*, 118 J. TAX'N 157 (Mar. 2013).

§ 18.05 (CONFLICTS IN REPRESENTATION)

For another example of a conflict of interest issue arising in a tax case see *Harbin v. Commissioner*, 137 T.C. 93 (2011), discussed in more detail in Section 17.02[B][5] of this Supplement. The attorney in *Harbin* represented both husband and wife in a contested divorce proceeding and a tax deficiency case arising from a jointly filed return. The attorney also represented the husband in his request for innocent spouse relief. The attorney claimed that he was "unaware of any ethical violations or issues" but withdrew once the conflict of interest was brought to his attention. *Id.* at 96. The Tax Court found that the conflict obstructed the husband's participation in the earlier deficiency case, thus he was not barred from seeking innocent spouse relief because of *res judicata*. *Id.* at 99.

Chapter 19

§ 19.02 (CLIENT INTERVIEWING)

The statement on page 739 of the text about submitting powers of attorney online for purposes of accessing clients' transcripts needs to be updated. In the summer of 2013, the IRS announced it would no longer accept such online submissions. *See* William Hoffman, *Year in Review: the IRS's 2014 Troubles May Mirror Its 2013 Problems*, 142 TAX NOTES 36, 37 (2014) ("[T]he IRS ended its electronic submission of disclosure authorization and electronic account resolution applications in August 2013, and replaced them with paper Form 2848, 'Power of Attorney and Declaration of Representative,' and Form 8821, 'Tax Information Authorization,' which must be mailed or faxed. The move was sharply criticized by the AICPA, among others."). The move away from online filing was budget-motivated: "The fact that we're moving critical services, in this case back to paper, is not the direction we want to take the organization," [acting IRS Commissioner Daniel] Werfel [said] . . . . 'But again, ultimately there's a budget constraint that we have, and we have to make some tough choices along the way.'" William Hoffman, *IRS Must Reduce Services If Congress Cuts Budget, Werfel Says*, 141 TAX NOTES 589, 589 (2013).

By contrast, in a 2015 report, the Electronic Tax Administration Advisory Council recommended that the IRS move to a "digital-first" model that would allow taxpayers and their representatives to access taxpayer accounts online. ELECTRONIC TAX ADMINISTRATION ADVISORY COMMITTEE ANNUAL REPORT TO CONGRESS: JUNE 2015, DEPARTMENT OF THE TREASURY (2015), *available at* http://www.irs.gov/pub/irs-pdf/p3415.pdf. The report made recommendations linked to the following "key outcomes": (1) an "[a]ccelerated digital-first taxpayer service strategy . . ."; (2) "Increased taxpayer preference for comprehensive and easy-to-use IRS digital service tools . . ."; (3) an "IRS digital-first strategy advanced across the industry through tax software providers and tax professionals . . ."; and (4) "Improved website experience that provides relevant and accurate information in a user-friendly format to support a digital-first taxpayer service strategy." *Id.* at 2.

§ 19.02[A] (Goals and Structure of the Client Interview)

Although commonalities help to build "rapport, trust, and engagement," attorneys must not let these connections blind them to important cultural differences. Alexis Anderson et al., *Challenges of "Sameness": Pitfalls and Benefits to Assumed Connections in Lawyering*, 18 CLINICAL L. REV. 339, 341 (2012). The article concludes:

> Shared personal characteristics and shared life experiences can be powerful connectors in our working relationships with clients. They can also help us to understand and appreciate more fully a particular client's legal problem and to be more effective advocates. In addition to these possible benefits, there are also

> potential risks inherent in sameness and assumptions of sameness—risks frequently related to overidentification, projection, countertransference, or self-disclosure of sameness. Identifying and addressing those potential risks—role confusion, boundary issues, the narrowing of our focus, and impaired judgment—are critical to effective lawyering.

Id. at 388–89.

In an article on what clients want from attorneys, another scholar concludes:

> After decades of empirical research, the medical profession has concluded good doctor-patient communication is not only what patients want from their physicians but also leads to better health outcomes. As a result—unlike the legal profession—effective communication is not only a standard component of the medical school curriculum but also must be demonstrated, through successful performance of a series of Simulated Patient assessments, in order to receive a medical license in the United States. The legal profession has a long way to go to match this level of commitment to assuring professional competence in communication, but the first step is the recognition that effective lawyer-client communication is not only an essential component of client representation but also the most important thing many clients want from their lawyers.

Clark D. Cunningham, *What Do Clients Want From Their Lawyers?*, 2013 J. DISP. RESOL. 143, 157 (2013).

For an article about winding up the attorney-client relationship, see Gail E. Silverstein, *All's Well That Ends Well: The Importance of Full and Effective Closure in Lawyer-Client Relationships*, 19 CLINICAL L. REV. 555, 577 (2013) ("Feedback from clients may lead lawyers to appreciate the need for changes in their practices that they might not otherwise see, due to the blind spots in their professional role. It holds out the potential not only to improve one's services, but to demonstrate to clients that the lawyer is client-driven.").

§ 19.02[B][2] (Language Barriers)

A bilingual attorney can be a significant asset in representation. As one article explains:

> Attorney bilingualism can reshape the relationship between lawyers and their clients in ways that are at once subtle and deeply transformative. Naturally, attorney bilingualism facilitates communication with LEP [limited English proficient] and NEP [non-English proficient] clients and allows lawyers to work more expeditiously. Beyond these pragmatic benefits, however, the ability to speak in a shared language allows the lawyer to convey certain values about the relationship and also permits a potentially deeper connection to be forged. Moreover, as a corollary to these dignity-related client concerns, thoughtful

> bilingualism also enables attorneys to more fully realize the ethical standards that guide the profession.

Jayesh M. Rathod, *The Transformative Potential of Attorney Bilingualism*, 46 U. MICH. J. L. REFORM 863, 883 (2013).

Chapter 20

§ 20.02[A][3] (Joint Committee Explanation (“Bluebook”))

The Supreme Court’s decision in *Woods v. United States*, 134 S. Ct. 557 (2013), discussed in Section 12.02[C][3] of this Supplement, addresses the authority of Bluebooks in tax cases:

> Blue Books are prepared by the staff of the Joint Committee on Taxation as commentaries on recently passed tax laws. They are “written after passage of the legislation and therefore d[o] not inform the decisions of the members of Congress who vot[e] in favor of the [law].” Flood v. United States, 33 F. 3d 1174, 1178 (CA9 1994). We have held that such “[p]ost-enactment legislative history (a contradiction in terms) is not a legitimate tool of statutory interpretation.” Bruesewitz v. Wyeth LLC, 562 U. S. 223, 242, . . . (2011); accord, Federal Nat. Mortgage Assn. v. United States, 379 F. 3d 1303, 1309 (CA Fed. 2004) (dismissing Blue Book as “a post-enactment explanation”). While we have relied on similar documents in the past, *see* FPC v. Memphis Light, Gas & Water Div., 411 U. S. 458, 471-472 . . . (1973), our more recent precedents disapprove of that practice. Of course the Blue Book, like a law review article, may be relevant to the extent it is persuasive. But the passage at issue here does not persuade. It concerns a situation quite different from the one we confront: two separate, non-overlapping underpayments, only one of which is attributable to a valuation misstatement.

Woods, 134 S. Ct. at 568.

§ 20.05 (COMPUTER-ASSISTED RESEARCH)

A 2014 article describes Web resources that provide free information about federal and state taxes. William P. Brown, *Free Tax Resources on the Internet: A Selected Bibliography*, 45 TAX ADVISER 908 (2014). They include the Cornell University Law School website, which provides up-to-date versions of the Internal Revenue Code, and the U.S. Tax Court website, which provides an archive of Tax Court opinions.